TAB 1

LEXSEE 2008 DEL. CH. LEXIS 50

DEL-CHAPEL ASSOCIATES, a Delaware general partnership, and THOMAS L. RUGER and ERIS MARIE SCOTT, Plaintiffs, v. CONECTIV, a Delaware corporation, Defendant.

C.A. No. 19498-VCL

COURT OF CHANCERY OF DELAWARE

2008 Del. Ch. LEXIS 50

January 22, 2008, Submitted
May 5, 2008, Decided

NOTICE:

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JUDGES: Vice Chancellor LAMB.

OPINION BY: LAMB

OPINION

MEMORANDUM OPINION AND ORDER

LAMB, Vice Chancellor.

This is an action for trespass that ultimately concerns the possessory rights of defendant electric power utility that acquired a license to string electric wires and related facilities along a railroad right of way from Conrail (and its predecessors in interest) at a time the right of way was being used for railroad purposes. Sometime later, Conrail abandoned its use of the lands in question and, through a series of transactions, the plaintiffs came to hold a variety of legal interests in the parcels land comprising the old right of way.

The issue presented in this motion for partial summary judgment filed by the plaintiffs is whether their possessory interest in the property is subject to the utility's license. The utility's license, however, was both expressly and impliedly terminable upon the termination of Conrail's possessory interest in the property. Thus, because Conrail's abandonment of the right [*2] of way for railroad purposes terminated all of its interest in the large parts of the right of way it did not own in fee simple absolute, the utility's license also largely ended at that time, and its continued occupation of substantial parts of the land is without justification.

I.

A. The Parties

Del-Chapel Associates ("Del-Chapel") is a Delaware partnership in which Thomas L. Ruger and Eris Marie Scott (as successor to her late husband, Virgil) are principals. Between 1987 and 2001, Virgil Scott, Ruger, and a third individual acquired the parcels of land along both sides of a former railroad right of way. Over time, Del-Chapel came to own some of those parcels.

The named defendant is Conectiv, Inc., a Delaware corporation. A footnote to the answer states that Conectiv is a holding company of the stock of Delmarva Power & Light Company. The complaint has not been amended to show this relationship, but Delmarva has actively defended the case on Conectiv's behalf.

B. Facts

This trespass action involves seven parcels of land that were once part of the Pomeroy Branch Railroad's spur located in Newark, Delaware. The parcels are known as parcels 5-5, 5-7, 5-10, 5-11, 5-12, 6-3, and 6-6 (collectively, [*3] the "Parcels"). According to one of the deeds in the record, the total property comprises a

tract with the dimensions of 50 feet wide by 1.4 miles long, totaling approximately 12.5 acres. The railroad companies that operated along this spur owned a variety of legal interests in the land. For example, title to parcels 5-7 and 6-6 was held in fee simple absolute. By contrast parcel 5-5 was held as a fee simple determinate, and the remaining parcels consisted of mere of rights of way. Ultimately, these various interests came to be held by Consolidated Railroad Corporation ("Conrail"). As the law now recognizes, the railroad companies retained possessory interests in parcel 5-5 and those rights of way only so long as they used the land for railroad purposes. [1]

1 *See Smith v. Smith, 622 A.2d 642, 647-48 (Del. 1993)*; *State ex. rel. Dep't of Trans. v. Penn Central Corp., 445 A.2d 939, 943-45 (Del. Super. 1982)*.

Beginning in or about 1939, Delmarva entered into the first of six license agreements with the operators of the spur rail line. The first five licenses were with the Pennsylvania Railroad Company (itself a lessee of the property) and had the same general form, allowing for the installation **[*4]** and upgrading of electric power transmission facilities, the payment of annual license fees, and the indemnification of the railroad for loss. These licenses all provided that "the Railroad Company, in consideration of the payments and privileges herein named, hereby grants to the Licensee, insofar as the Railroad Company's present title enables it so to do, the right to construct, use, maintain, renew and remove the said wires, cables, pipe lines, and appurtenances at the said location . . . ." [2] Pursuant to these licenses, Delmarva installed poles, wires and other equipment necessary for the transmission of electricity over the Parcels. There is no dispute that these electric power transmission facilities were on the Parcels and obvious at all relevant times.

2 PX 16.

By 1981, Conrail was the operator and was offering the Parcels for sale. Although Delmarva was apparently aware of these facts, it did not pursue a purchase of the Parcels. Rather, in January 1982, Conrail and Delmarva entered into the final license agreement. The 1982 license agreement differed from its predecessors in several respects. Notably, the consideration changed from relatively modest annual amounts to a lump **[*5]** sum of $ 116,000, and a clause was added making the license terminable upon mutual consent. [3] The 1982 license agreement also contained a new paragraph stating:

> Anything herein contained to the contrary notwithstanding, there shall be no obligation on the part of the Railroad to continue operation of the line of railroad in the vicinity of the FACILITIES to prevent the termination of the Licensee's occupation rights . . . on account of an abandonment of line or service by the Railroad; nor shall there be any obligation upon the Railroad to perfect its title in order to continue in existence the said occupation rights after such abandonment of line or service. [4]

3 PX 7 P 15. The paragraph states in full: "This Agreement shall be terminable upon mutual consent of the parties hereto, provided that this Agreement may be terminated by the Railroad upon the violation of any of the terms, covenants and conditions of this Agreement on the part of the Licensee which are not timely and reasonably cured."

4 *Id.* P 17.

On October 22, 1982, Conrail notified the Delaware Department of Transportation ("DelDOT") that it "intended" to abandon the railroad spur. [5] Still, Delmarva made no attempts to purchase **[*6]** the land. Rather, nearly four years later, on October 17, 1986, Ruger, Scott, and their associate contracted to purchase Conrail's interest in the entire spur, including all of the Parcels, from Conrail. Conrail quitclaimed its interest in the spur to them on February 25, 1987, for a purchase price of $ 275,000. [6] The quitclaim deed states that the purchasers took the railroad spur "UNDER and SUBJECT, however, to . . . (3) any easements or agreements of record or otherwise affecting the land hereby conveyed, and to the state of facts which a personal inspection or accurate survey would disclose, and to any pipes, wires, poles, cables . . . or systems and their appurtenances now existing and remaining in, on, under, over, across, through the herein conveyed premises . . . ." [7] In addition, Conrail reserved the right to enter the property and remove the rail and railroad facilities and did so in the summer of 1987.

5 Under Delaware law, it was illegal for Conrail to abandon the property until Conrail gave such notice pursuant to *2 Del. C. § 1803*.

6 PX 6.

7 *Id.*

By the time that settlement occurred, circumstances had arisen clouding title to various Parcels. [8] Specifically, Conrail held only **[*7]** a fee simple determinable interest in parcel 5-5 and only held railroad rights of way to parcels 5-10, 5-11, and 5-12. Once Conrail abandoned

any use of the spur for railroad purposes, questions arose about the continuing validity of Conrail's title to parcel 5-5 due to the possibility that title reverted to the heirs of the property owners who made the original conveyances to Conrail in 1883, William Dean and Margaret Dean (the "Dean heirs"). [9] Similarly, the act of abandonment called into question the continued validity of the railroad rights of way. [10] Thus, the only certain effect of the 1987 quitclaim deed was to convey fee simple absolute title only as to parcels 5-7 and 6-6. As eventually became apparent, the acquisition of good title to the parcels other than parcels 5-7 and 6-6 depended on acquiring ownership of the abutting properties, as the owners of those properties were eventually recognized as having the fee simple interests in those lands.

8 *See Ruger v. Funk, No. 04-210, 1996 Del. Super. LEXIS 34, 1996 WL 110072, at *1 (Del. Ch. Jan. 22, 1996).*
9 *See Penn Central, 445 A.2d 939.*
10 *See Smith, 622 A.2d at 647.*

The plaintiffs went about acquiring good title to the other parcels in a variety of ways. They **[*8]** had already separately obtained title in land referred to as the Budd Plant property that straddled parcels 5-11 and 5-12. [11] Some years later, after cases were decided holding that the cessation of the use of railroad rights of way for railroad purposes results in a termination of the right of way, Del-Chapel filed a quiet title action with respect to parcels 5-11 and 5-12, and this court entered an order quieting title on April 28, 1999.

11 PX 10.

In 1987, the Dean heirs filed suit in the Court of Chancery seeking a determination of their rights with respect to parcel 5-5. By order of October 20, 1989, this court determined that Ruger, Scott, and their associate were "vested with color of title to the property." [12] They then filed a quiet title action against the Dean heirs, and obtained a quitclaim deed for parcel 5-5 in exchange for a cash payment. [13]

12 *See Ruger, 1996 Del. Super. LEXIS 34, 1996 WL 110072, at *1.*
13 PX 14, 24.

In 1997, Ruger and Scott obtained quitclaim deeds to three parcels of land abutting parcel 5-10. At the same time, Del-Chapel obtained a deed to the fourth parcel of land abutting parcel 5-10. [14] Through these purchases, the plaintiffs obtained fee simple title to parcel 5-10. Del-Chapel's **[*9]** title to parcel 6-3 has never been established.

14 PX 15.

In 1999, the plaintiffs conveyed by deed parcels 5-11, 5-12, 6-3, and 6-6 to CHF-Delaware, LLC. As part of the transaction, Del-Chapel retained by separate instrument a perpetual easement over these parcels. [15] In 2005, the plaintiffs conveyed by deed parcels 5-5, 5-7, and 5-10 to DelDOT. [16] In that deed of conveyance, the plaintiffs again reserved a perpetual easement over the conveyed parcels. [17]

15 PX 4.
16 PX 5.
17 In each of the deeds, CHF-Delaware and DelDOT retained the right to maintain this action and to damages.

Delmarva continues to have electric power transmission facilities running over the land. Rather than condemn the Parcels pursuant to legislation passed by the General Assembly in 1994 allowing public utility companies to acquire by condemnation an easement over lands that were formerly railroad rights of way, Delmarva relies on the 1982 license agreement with Conrail to justify its assertion of a right of possession. [18]

18 *26 Del. C. § 908.*

II.

To prevail on summary judgment, the moving party must "demonstrate that no genuine issue of material fact exists and that it is entitled to judgment as a matter of law." [19] "The court **[*10]** must view the evidence presented in the light most favorable to the non-moving party, and the moving party bears the burden of demonstrating the absence of a material factual dispute." [20] Once the moving party has demonstrated such facts, and those facts entitle it to summary judgment, the burden shifts to the non-moving party to present "specific facts showing that there is a genuine issue of fact for trial." [21] The non-moving party "may not rest upon the mere allegations or denials [contained in the pleadings]." [22]

19 *Levy v. HLI Operating Co., Inc., 924 A.2d 210, 219 (Del. Ch. 2007).*
20 *Id.*
21 *Id.* (citing Court of Chancery Rule 56(e)).
22 *Id.*

The tort of trespass consists of entry onto real property without the permission of the owner. [23] Like an action for ejectment, trespass is a possessory action. [24] Thus, "in order to maintain such an action, the plaintiffs . . . have to show that the defendant made an unauthorized entry . . . or otherwise physically interfered with their right to possession and use." [25] In a case such as this, in which both parties claim a right to possession and use in the disputed land, "the parties [are] both put upon their

proof of title, and that party must prevail [*11] who [proves] the legal title to be in him." [26]

23 *See Fairthorne Maint. Corp. v. Ramunno, No. 2124, 2007 Del. Ch. LEXIS 107, 2007 WL 2214318, at *5 (Del. Ch. July 20, 2007).*

24 *Old Time Petroleum Co. v. Tsaganos, No. 5218, 1978 Del. Ch. LEXIS 686, 1978 WL 4973, at *3 (Del. Ch. Nov. 8, 1978)* (stating "[t]he gist of an action of trespass upon the freehold is the injury to the possession") (citing *Ripley v. Yale, 16 Vt. 257, 260 (1844)).*

25 *Burris v. Cross, 583 A.2d 1364, 1377 (Del. Super. 1990)* (citing *Heathergreen Commons Condo. Ass'n v. Paul, 503 A.2d 636, 643 (Del. Ch. 1985)).*

26 *Spicer v. Dashiells, 28 Del. 493, 5 Boyce 493, 94 A. 901, 902 (Del. Super. 1915).*

III.

In this case, both Delmarva and the plaintiffs claim a right to possession and use in the Parcels. Specifically, Delmarva argues that its interest in the Parcels derives from the 1982 license between itself and Conrail, is superior to any interest that the plaintiffs might have in the Parcels, and therefore the plaintiffs cannot maintain this trespass action. As a result, the court must analyze each party's claim to use and possess the Parcels and then determine whose right is superior.

A. The Plaintiffs' Interest

The parties agree that the plaintiffs have at least color of title in each of the Parcels. Specifically, [*12] Delmarva does not contest that Conrail quitclaimed its interest in the spur to Ruger, Scott, and their associate on February 25, 1987, [27] thereby conveying its fee simple interest in parcels 5-7 and 6-6. Nor does Delmarva contest that Conrail abandoned the spur by 1987, thereby causing title in the other Parcels to revert to owners of land abutting parcels 5-5, 5-10, 5-11, and 5-12. Relatedly, the parties agree that Ruger, Scott, and their associate purchased the Budd Plant property, which abuts parcels 5-11 and 5-12, in 1979, and that Ruger and Scott obtained quitclaim deeds to three parcels of land abutting parcel 5-10, while Del-Chapel obtained one deed to a fourth parcel of land abutting parcel 5-10. [28] Therefore, there is no dispute that the plaintiffs obtained fee simple title in those three parcels. Finally, the parties agree that the plaintiffs obtained a quitclaim deed from the Dean heirs for parcel 5-5 as part of a settlement in 1990. Thus, Delmarva has made no argument seriously challenging that the plaintiffs obtained color of title in the Parcels. The plaintiffs then sold the Parcels in 1999 and 2005, retaining the easements upon which this trespass action is based.

27 PX [*13] 6.

28 PX 15.

Delmarva challenges the validity of these easements, pointing out that the plaintiffs have not paid taxes on the land, maintained them as assets in their financial records, or sought to develop the easements even though they were retained for the purpose of installing and maintaining telecommunications and electric power transmission facilities. These alleged deficiencies, however, do not render the easements legally defective. There is no dispute that the plaintiffs bargained for, received, and recorded easements over the land. The plaintiffs' tax and financial treatments are wholly irrelevant; they are matters of tax, accounting, and partnership law, not property law. Further, as the plaintiffs note, Delmarva has interfered with the plaintiffs' ability to develop the land. In fact, the plaintiffs' notices to Delmarva of its trespass, and their attempts to have Delmarva removed from the property or pay for using it, can be seen as attempts to develop the easements for their retained purposes.

Delmarva further contends that alleged procedural errors in the actions to quiet title in parcels 5-5, 5-10, 5-11, and 5-12 were so fundamental as to render the orders issued in those [*14] actions unenforceable. Specifically, Delmarva argues that on March 5, 1990, the plaintiffs' title insurance company filed an action against the Dean heirs to quiet the plaintiffs' title in parcel 5-5. Paragraph 16 of the complaint stated that the plaintiffs would join all parties "if any, known or unknown, to own or use the Property." The plaintiffs were fully aware that Delmarva was using the property, yet Delmarva was never joined as a party. The plaintiffs did, however, publish notice of the litigation. Eventually, they negotiated a settlement with the Dean heirs in which they received their quitclaim deed in parcel 5-5 from the Dean heirs in return for a cash payment. The court later entered a quiet title order as to parcel 5-5.

Delmarva argues that the court approved the settlement and entered its quiet title order based on the plaintiffs' false representations that they would join all parties known to use the property. Delmarva also states that had it been given notice of the action, it would have attempted itself to negotiate a settlement with the Dean heirs. Therefore, Delmarva argues, the plaintiffs are judicially estopped from arguing that they ever had quiet title in parcel [*15] 5-5. In addition, Delmarva owned property abutting the southwest side of parcel 5-5 and claims that, due to this property interest, "procedural due process required" that it be given notice.

Delmarva also challenges the plaintiffs' conduct in the 1999 action filed to quiet title in parcels 5-11 and 5-12. Delmarva was named as a defendant, given notice, and participated in the proceedings. Nevertheless, according to Delmarva, the plaintiffs again deprived Delmarva of its due rights and acted inequitably in the litigation. Specifically, Delmarva argues that its counsel advised the court at an April 20, 1999 hearing that the plaintiffs would grant Delmarva an easement for its power lines. The plaintiffs' counsel did not object. In addition, Delmarva points out that the court expressly advised the plaintiff to give notice to all parties, including Delmarva, prior to entry of any orders. According to Delmarva, however, Delmarva was never given such notice and was never given an easement. Accordingly, Delmarva argues that the plaintiffs acted inequitably, and therefore cannot argue that they had quiet title in those parcels.

The court finds that these errors did not affect the validity of **[*16]** the quiet title orders. As to the order quieting title in parcel 5-5, Delmarva has not shown that the plaintiffs' failure to join it in litigation quieting title in parcel 5-5 was improper. Delmarva knew by 1981 that the railroad spur was for sale and it did not need notice of the quiet title action to enter into negotiations with the Dean heirs; it simply needed to approach the Dean heirs and negotiate. Instead, Delmarva sat idly by while the plaintiffs negotiated the purchase of parcel 5-5. That Delmarva did not act on its own suggests that Delmarva had no intention to negotiate with the Dean heirs whether it received notice of the plaintiffs' action or not. Further, it is noteworthy that, before the quiet title action was filed, the Court of Chancery found that two owners of land abutting parcel 5-5 had no color of title to the parcel. [29] The plaintiffs' published notice of the action provided Delmarva notice fitting to its interest.

29 *See* PX 23 (order in *Matt Slapp Subaru, Inc. v. Ruger, et al.* and *Pomeroy Realty Co. v. Ruger, et al.*, Case Nos. 8997 and 8998 (Del. Ch. Oct. 20, 1989)).

Similarly, the alleged errors in the action to quiet title in parcels 5-10, 5-11, and 5-12 did not **[*17]** render the quiet title order invalid. First, Delmarva overstates the plaintiffs' alleged promise to give Delmarva an easement. At the April 20, 1999 hearing, Delmarva's counsel noted the possibility that discussions over the grant of such an easement could "break down." [30] Delmarva likewise overstates the extent of the plaintiffs' counsel's allegedly improper conduct. Delmarva believes that the plaintiffs acted inequitably simply because the plaintiffs' counsel did not object to Delmarva's counsel's representation about the promised easement at the hearing. But counsel's silence is quite different than an affirmative representation, and Delmarva's counsel chose not to have the plaintiffs' counsel confirm his understanding in open court.

30 PX 32 at 14 (transcript of rule to show cause hearing, *Del-Chapel Assoc. v. Ruger, et. al,* Case No. 16942 (Del. Ch. Apr. 20, 1999)).

In addition, the court finds nothing inequitable about the court's entry of the order without notice to Delmarva. Delmarva should not have been surprised that an order quieting title was entered shortly after the April 20, 1999 hearing. At the hearing, the court told Delmarva's counsel, "[w]e all know this has to be done **[*18]** in very short order," and admonished Delmarva's counsel to speak with the plaintiffs' counsel about the proposed easement. [31] Yet Delmarva's counsel never initiated such discussions. For these reasons, the court does not find that the plaintiffs acted inequitably in the action to quiet title in parcels 5-10, 5-11, 5-12.

31 *Id.* at 28-29.

B. Delmarva's Interest

Delmarva's alleged interest in the Parcels derives from the 1982 Conrail license. That agreement states that Delmarva has the right to use the Parcels for specific activities "insofar as [Conrail] has the legal right and its present title permits" Conrail to confer such rights of use. Thus, by the terms of the license, Delmarva's interest in the Parcels is derivative of and dependent upon the existence of Conrail's interest in the Parcels. This arrangement makes sense, as Conrail could not convey an interest in land to Delmarva that was greater than the interest it held. [32] Thus, when Conrail abandoned the use of the spur for railroad purposes--losing its rights of way and its fee simple determinable interest--Delmarva simultaneously lost its license to that land. The parties agree that Conrail's interest in parcels 5-5, 5-10, 5-11, **[*19]** 5-12, and 6-3 terminated once Conrail ceased using the land for railroad purposes. Although the exact date of this abandonment is disputed, it is undisputed that Conrail abandoned the railroad no later than 1987. Consequently, Delmarva's license to use these parcels terminated no later than 1987.

32 *Forwood v. Delmarva P & L Co., No. 10948, 1998 Del. Ch. LEXIS 49, 1998 WL 136572, at *8 (Del. Ch. Mar. 16, 1998)* (noting that Delmarva's license in that case "was derivative of and dependent on [its licensor's] right of way" and terminated when the licensor abandoned the right of way); *see also Anolick v. Holy Trinity Greek Orthodox Church, Inc., 787 A.2d 732, 740 n.11 (Del. Ch. 2001)* (holding "[n]o deed can operate so as to convey an interest

which the grantor does not have in the land described in the deed, or so as to convey a greater estate or interest than the grantor has") (quoting 23 AM. JUR. 2D *Deeds* § 336 (1983)); *Scureman v. Judge, 626 A.2d 5, 16 (Del. Ch. 1992)*; *75 AM. JUR. 2d Trespass § 77* (2008) (stating "the actor's privilege to enter land created by consent of the possessor is terminated . . . by a transfer or other termination of the possessor's possessory interest in the land"); *RESTATEMENT (SECOND) OF TORTS § 171* **[*20]** (1965) (explaining that "[a] consent given by one in possession of land ceases to be effective as conferring a privilege to enter or remain, when the interest of the licensor in the land is terminated").

Nonetheless, Delmarva argues that the plaintiffs took title to the Parcels subject to the 1982 license, and that therefore Delmarva retains an interest in the Parcels sufficient to defeat the plaintiffs' trespass action. Delmarva argues that its license has become irrevocable due to the large expenditures it made developing the land in reliance on the license. Delmarva further contends that the license could only be terminated by mutual consent, and it did not give such consent. Finally, Delmarva maintains that it has gained title to the Parcels through adverse possession. Delmarva claims that the license remains intact as to each and every parcel of land identified in the license, including those over which Conrail had only a right of way or fee simple determinable. Alternatively, Delmarva argues that even if the license is terminated as to the parcels over which Conrail simply had a right of way or fee simple determinable, it remains effective over parcels 5-7 and 6-6, which Conrail **[*21]** held in fee simple.

1. Irrevocable License

It is true that a license can become irrevocable, at least between the parties to the license and those in privity with them, where the licensee expends a large amount of money to make permanent improvements on the land under the justifiable assumption that the parties intended the license to be permanent. [33] In this case, the license was of no fixed duration, being terminable by mutual consent. Notably, however, paragraph 17 of the 1982 license clearly reflects the parties' shared understanding that "the Licensee's occupation rights at any crossing or occupation covered hereunder" might terminate should Conrail abandon its use of the spur for railroad purposes. [34] That is, the license itself demonstrates Delmarva's awareness that the abandonment of that use by Conrail could lead to the termination of its right to occupy some or all of the property in question. This is in keeping with the general principle that Conrail, as licensor, could not grant rights greater than it possessed. [35] Because Conrail's possessory rights over large segments of the spur always depended on its continued use of the property for railroad purposes, its power to grant **[*22]** licenses to others to use that property was similarly circumscribed. For these reasons, the court rejects the argument that the 1982 license, in its entirety, became irrevocable.

33 *Carriage Realty P'ship v. All-Tech Auto Auto., Inc., No. 18440, 2001 Del. Ch. LEXIS 144, 2001 WL 1526301, at *8 (Del. Ch. Nov. 27, 2001)* (collecting cases); *Jackson & Sharp Co. v. Philadelphia, Wilmington and Baltimore Railroad Co., 4 Del. Ch. 180 (Del. Ch. 1871)* (refusing to hold that license had been rendered irrevocable because "although the connection of the car works with the railroad was doubtless contemplated on both sides as one to be in fact permanent," "[i]t [was] agreed that no stipulation or promise" that the license become irrevocable was expressed by the parties, "nor did the general usage connected with granting this sort of accommodation by the [licensor] justify the inference that a perpetual easement in this track was conceded . . .").

34 PX 7 P 17.

35 *See supra* note 32.

2. Adverse Possession

To establish a prescriptive right in real estate, Delmarva must demonstrate that its occupation has been open, notorious, adverse, continuous, and exclusive for 20 years. [36] According to Delmarva, Conrail abandoned the railroad in **[*23]** 1981 when it put the spur up for sale, presumably because it had ceased operating a railroad. Delmarva argues that at that point its license expired, thus making its continued maintenance of electric power transmission facilities on the Parcels open, notorious, adverse, and exclusive. Further, because this complaint was filed on March 22, 2002, Delmarva argues its adverse possession was continuous for over 20 years. The plaintiffs assert that Conrail abandoned the railroad much later, either when it sold the property to the plaintiffs or removed the railroad tracks in 1987. Thus, according to the plaintiffs, the 1982 license remained in force until 1987, making Delmarva's use of the Parcels permissive, rather than adverse, until that time.

36 *See Cox v. Lakshman, 567 A.2d 34 (Del. 1989)* (TABLE); *10 Del. C. § 7901.*

Delmarva has not established that its use of the Parcels has been adverse for over 20 years, or that there is a material dispute as to the date on which Conrail abandoned the railroad spur. First, as late as July 1987, Delmarva met with and asked Ruger and Scott for permis-

sion to change a static wire on its facilities pursuant to its license agreement. This fact alone demonstrates **[*24]** that Delmarva did not view its possession as adverse before 1987. Second, Delmarva's argument that Conrail abandoned the railroad spur when it ceased operations in 1981 is unreasonable. As an initial matter, the argument is entirely inconsistent with the fact that Delmarva and Conrail entered into the 1982 license agreement in January 1982. It is difficult to imagine that Delmarva entered into that agreement and paid $ 116,000 believing that Conrail already lacked the power to convey such a license. More importantly, a mere cessation or interruption of operations on a railroad does not equate to abandonment of the right of way. Rather, abandonment of a railroad depends upon a showing of the intent to abandon and some act carrying out the intent. [37]

37 *Penn Central, 445 A.2d at 948.*

Viewing this standard generously in favor of Delmarva, the earliest date Conrail could have abandoned the railroad was October 22, 1982, when it notified DelDOT of an *intent* to abandon the right of way. As a result, Delmarva's possession was not adverse for the requisite 20 years when suit was filed in March 2002, and its adverse possession claim fails.

3. Parcels 5-7 And 6-6

Delmarva points out that the 1999 **[*25]** easement by which the plaintiffs retained their interest in parcels 5-11, 5-12, and 6-3 after selling them to CHF-Delaware states Del-Chapel took the easement "subject, at all times, to all matters of record or any state of facts that is apparent or that an accurate survey or inspection of the property would disclose." [38] According to Delmarva, the 1982 license was recorded, and the existence of its facilities on those parcels was apparent. Therefore, Delmarva argues, Del-Chapel took the easement subject to the license and the existing facilities.

38 PX 4.

Delmarva's problem is that when the sale of these lands took place in 1999 Delmarva no longer had a valid license with respect to them and continued to occupy those lands only as a trespasser. The general rule that a purchaser of land takes the land subject to burdens of which he or she had either actual or constructive notice applies only in those cases where there is actually a valid burden on the land. In this case, however, Delmarva's license had terminated at the time Conrail abandoned the right of way. [39]

39 The court questions whether the plaintiffs can be said to have granted Delmarva a license to use the Parcels simply because **[*26]** they purchased the land knowing about the presence of the poles, wires, and other equipment. *See 25 AM. JUR. 2d Easements and Licenses § 118, 121* (2008). In this case, the plaintiffs did not obtain title to parcel 5-5 until 1990. They were unsure of the exact nature of their title in parcels 5-11 and 5-12 until the *Smith* decision was rendered in 1993. And the plaintiffs purchased parcel 5-10 in 1997. Yet as early as 1990, the plaintiffs had informed Delmarva that its facilities were trespassing on parcels 5-6 and 5-7. Regardless, to the extent an implied license can be found in this case, such a license would be revocable for the same reasons that the 1982 license is revocable--there was no understanding that the license was to be permanent. *See supra* note 33; *see also Hionis v. Shipp, No. 270, 2005 Del. Ch. LEXIS 92, 2005 WL 1490455, at *4 (Del. Ch. June 16, 2005).*

This reasoning does not apply, however, with the same force with respect to parcels 5-7 and 6-6, which Conrail owned in fee simple absolute. As to those parcels, Conrail's powers were not circumscribed by its continued use of the property for railroad purposes. Thus, Conrail was free to commit itself and its successors and assigns to the full terms **[*27]** of the license. Moreover, when it quitclaimed those parcels to the plaintiffs, the grant was specifically made subject to licenses of record and to any wires, poles cables, etc. then existing "together with the right to maintain, repair, renew, replace, use and remove the same." Thus, the plaintiffs took their interest in parcels 5-7 and 6-6 subject to Delmarva's license, and it would be inequitable to deprive Delmarva of the rights it has in those parcels simply because its rights in others terminated.

Nonetheless, Delmarva's license as to parcels 5-7 and 6-6 terminated because Delmarva breached the 1982 license agreement. The preamble of the 1982 license agreement precisely articulates the scope of use granted to Delmarva. It provides Delmarva the right to construct, maintain, repair, alter, renew, relocate, and ultimately remove: (1) one circuit, 34,000 volts, (2) one circuit, 138,000 volts, and (3) the poles, anchors, and guys necessary to support those circuits. The license also provides: "The rights conferred hereby shall be the privilege of the Licensee only, and no assignment or transfer hereof shall be made, or other use be permitted than for the purpose stated on page one **[*28]** without the consent and agreement in writing of the Railroad being first had and obtained." [40] Notably, the license grants the licensor the right to terminate the license "upon the violation of any of the terms, covenants and conditions of this Amendment on the part of the Licensee whicb are not timely and reasonably cured." [41]

40 PX 7 at P 14.
41 PX 7 P 15.

Despite these clear terms, Delmarva admits that, in 1998, it installed a 96 strand fiber optic cable over the Parcels. Delmarva subsequently assigned the use of this cable to an unrelated communications company called Cavalier Telephone. Ruger testified at his deposition that in 1999, shortly after the cable was installed, he called Delmarva and was directed to an individual named Terry Vance. According to Ruger's deposition testimony, Ruger told Vance that Delmarva had no authority to install the cable. Nevertheless, Delmarva did not remove the cable. In addition, the complaint filed in March 2002 similarly put Delmarva on notice of the plaintiffs' objection to the cable. [42] Still, Delmarva has not removed the cable. Delmarva's only defense is that installation of the cable was a *de minimis* alteration "given the size and breadth of **[*29]** the existing Delmarva facilities" that in "no way meaningfully alter[s] operations or appearance." [43] At the very least, Delmarva argues, there is a question of fact as to whether the cable constitutes more than a *de minimis* breach of the license.

42 Compl. P 16.
43 Def.'s Ans. Br. 29-30.

On these facts, it is clear that Delmarva has breached the 1982 license agreement. [44] The 1982 license agreement articulates the uses for which Delmarva has a license to use parcels 5-7 and 6-6, *viz.* installation, maintenance, and removal of two circuits of definite size, along with their supporting wires and poles. Because "this court has never recognized a *de minimis* exception to trespass liability," [45] and because Delmarva assigned the cable to an unrelated company in addition to installing it, Delmarva has exceeded the scope of its license. Delmarva was given notice of these violations, yet failed to cure. The plaintiffs thereby gained the right to terminate the license, which they have done. [46]

44 The plaintiffs originally argued that Delmarva also breached the license agreement by installing a "static wire" on its facilities. Delmarva responded that the wire was installed to upgrade the electric power **[*30]** transmission facilities, thereby falling under their right under the license to "renew" its facilities. The plaintiffs seem to have abandoned this claim, referring to the static wire only briefly in their reply as "a static wire . . . [Delmarva] portrayed as simply a maintenance upgrade." *See* Pls.' Reply Br. 26.

45 *Fairthorne, 2007 Del. Ch. LEXIS 107, 2007 WL 2214318, at *5 n.34* (citing *Barton v. Gillen,* No. 5090, 1976 WL 7940, at *1 (Del. Ch. Dec. 1, 1976)).

46 Of course this holding applies to the license in its entirety, but it is particularly salient with regard to parcels 5-7 and 6-6. This holding also comports with the general rule that one can be a trespasser despite "authority under [a] license to enter the property" if the actions taken exceeded the permission given. *Fairthorne, 2007 Del. Ch. LEXIS 107, 2007 WL 2214318, at *5 n.34* (citing *Gordon v. Nat'l R.R. Passenger Corp.,* No. 10753, 2002 WL 550472, at *5 (Del. Ch. Apr. 5, 2002)); *75 AM. JUR. 2d Trespass § 74* (stating "[c]onsent from the owner of land is a valid defense to a trespass action of acts done within its scope. The acts of the party accused of trespass must not exceed . . . the purposes for which the consent was given.").

C. The Plaintiffs Are Entitled To Partial **[*31]** Summary Judgment

Based on the foregoing, the undisputed, material facts demonstrate that the plaintiffs' right to possess and use the Parcels is superior to Delmarva's. The plaintiffs quieted title to parcels 5-5, 5-10, 5-11, and 5-12. Even assuming that the quiet title actions were invalid due to alleged errors, the plaintiffs have shown they obtained at least color of fee simple title in the Parcels. The plaintiffs then obtained recorded easements over the Parcels when the land was sold. In contrast, Delmarva has identified no interest that it retains in the Parcels. Instead, Delmarva's electric power transmission facilities remain on those parcels without the consent of anyone who holds a present possessory interest. Therefore, the plaintiffs have established Delmarva's liability for trespass. [47]

47 *See Fairthorne, 2007 Del. Ch. LEXIS 107, 2007 WL 2214318, at *5* (stating "elements of trespass are entry onto real property without the permission of the owner").

D. Laches And Balance Of The Equities

Delmarva makes arguments based on notions of laches, the balancing of hardships, and the public interest. These arguments relate to the remedy the plaintiffs seek, particularly whether the court will award them injunctive **[*32]** relief. [48] This motion for partial summary judgment, however, is limited to Delmarva's liability for trespass. Therefore, it is unnecessary to address these arguments at this time.

48 *Forwood, 1998 Del. Ch. LEXIS 49, 1998 WL 136572, at *9.*

IV.

For the reasons discussed herein, the plaintiffs' motion for partial summary judgment is GRANTED. IT IS SO ORDERED.

TAB 2

LEXSEE 2004 DEL CH LEXIS 130

DEEPHAVEN RISK ARB TRADING LTD., Plaintiff, v. UNITEDGLOBALCOM, INC., Defendant.

Civil Action No. 379-N

COURT OF CHANCERY OF DELAWARE, NEW CASTLE

2004 Del. Ch. LEXIS 130

May 14, 2004, Submitted
August 30, 2004, Decided

NOTICE:

[*1] THIS OPINION HAS NOT BEEN RELEASED FOR PUBLICATION IN THE PERMANENT LAW REPORTS. UNTIL RELEASED, IT IS SUBJECT TO REVISION OR WITHDRAWAL.

SUBSEQUENT HISTORY: Motion granted by *Deephaven Risk Arb Trading, LTD. v. UnitedGlobalCom, Inc., 2005 Del. Ch. LEXIS 107 (Del. Ch., July 13, 2005)*

DISPOSITION: Motion to dismiss denied.

COUNSEL: Attorneys for Plaintiff: John L. Reed, Esquire and Matthew Neiderman, Esquire of DUANE MORRIS LLP, Wilmington, Delaware.

Attorneys for Defendant: Michael Hanrahan, Esquire and Tanya P. Jefferis, Esquire of PRICKETT JONES & ELLIOTT, P.A., Wilmington, Delaware.

OPINION

MEMORANDUM OPINION

PARSONS, Chancellor

Deephaven Risk Arb Trading Ltd. ("Deephaven") brought this action, pursuant to *8 Del. C. § 220*, seeking to compel inspection of certain books and records of UnitedGlobalCom, Inc. ("UGC"). UGC moved to dismiss Deephaven's complaint under Court of Chancery Rule 12(b)(6) for failure to state a claim. For the reasons discussed below, the Court will deny UGC's motion.

I. FACTS [1]

1 Unless otherwise noted, the facts are as stated in the Complaint.

Deephaven is a British Virgin Islands company, and a wholly owned subsidiary of Deephaven Capital Management [*2] LLC. Deephaven has "at all relevant times" been a beneficial owner of shares in UGC. UGC is a Delaware corporation with its principal place of business in Denver, Colorado.

On January 12, 2004, UGC announced a $ 1 billion rights offering (the "Rights Offering") to holders of UGC Class A common stock. On January 21, 2004, those rights were distributed. Deephaven acquired over 5 million rights during the Rights Offering period. [2]

2 The parties dispute exactly how Deephaven acquired its rights. Deephaven asserted that it acquired them "through its ownership of [UGC's] Class A common stock." Compl. P 3. UGC alleges that Deephaven purchased the rights, which were transferable, from other UGC stockholders without the underlying shares and that whatever shares it held may have been "a short position which would not reflect any beneficial ownership of UGC stock at all." Defendant's Opening Brief ("DOB") at 4-5 & n.4, 21. For purposes of the motion to dismiss, the Court will accept as true the well-plead allegations in the Complaint. Nevertheless, Deephaven will have to prove at trial that it owned, of record or beneficially, some UGC stock at all relevant times.

[*3] Under the terms of the Rights Offering, each right entitled its holder to a basic subscription privilege and an oversubscription privilege. The basic subscription privilege entitled the holder to purchase one share of

Class A common stock at a price of $ 6.00. The oversubscription privilege entitled each rightsholder who had exercised his basic subscription privilege in full to purchase additional shares of common stock not already purchased by other rightsholders under the basic subscription privilege. The Rights Offering stated that it would expire on February 6, 2004 at 5:00 p.m. EST, and that no exercises of rights would be accepted after that time. It also stated that UGC had sole discretion to determine the timeliness, validity, form and eligibility of all exercises of rights. The Rights Offering period was later extended to February 12, 2004. The Rights Offering also authorized acceptance of notices of guaranteed delivery in lieu of completed subscription certificates, provided the completed subscription certificates were submitted by February 18, 2004.

On February 13, 2004, UGC issued a press release declaring that it had received subscriptions for 63.7 million of the 83 [*4] million rights, and that consequently there were about 19.3 million rights available for oversubscription privileges. [3] Deephaven alleges that, on February 19, 2004, one of its representatives had a conversation with a representative of UGC's subscription agent, Mellon Investment Services, LLC ("Mellon"), who confirmed that the original estimate of 19.3 million available rights was accurate. Deephaven also alleges that its representatives had conversations with UGC representatives, who said that the notices of guaranteed delivery received in connection with the Rights Offering would not materially affect the number of rights available for oversubscription.

3 Certificate of Tanya Jefferis ("Jefferis Cert.") Ex. C.

On February 20, 2004, however, UGC issued a final press release stating that it had received subscriptions for 82 million of the 83 million rights, leaving only about 1 million rights available for oversubscription. [4]

4 *Id.* Ex. D.

[*5] On February 24, 2004, Deephaven's counsel wrote to UGC to express its concern over the sudden change in available rights, [5] and to request that all relevant files, documents, and other information be preserved. UGC responded on March 1, 2004, and denied any "wrongful actions after the delivery deadline." [6] Subsequently, on March 24, Deephaven wrote to UGC demanding inspection of certain categories of UGC's books and records pursuant to *8 Del. C. § 220.* [7] Specifically, Deephaven's letter (the "Demand Letter") requested eleven categories of documents relating to various aspects of the Rights Offering and the manner in which it was executed. [8]

5 *Id.* Ex. B.
6 *Id.* Ex. E.
7 *Id.* Ex. I.
8

The categories of documents requested are:

1. All records including copies of taped phone conversations reflecting or referring to all elections of oversubscription rights in the 2004 Rights Offering;

2. All records reflecting or referring to all notices of guaranteed delivery received by the Company or its agents in connection with the 2004 Rights Offering;

3. All records reflecting or referring to the extension of the subscription period for the 2004 Rights Offering;

4. All records reflecting or referring to the subscriptions and notices of guaranteed delivery received by the Company or its agents in connection with the 2004 Rights Offering, including, without limitation, all records reflecting or referring to the date and time at which all such subscriptions and notices of guaranteed delivery were received by the Company or its agents;

5. All records reflecting or referring to communications concerning the receipt by the Company or its agents of subscriptions and/or notices of guaranteed delivery in connection with the 2004 Rights Offering, including, without limitation, any requests or demands that subscriptions or notices of guaranteed delivery be accepted or honored by the Company or its agents after the subscription deadline;

6. All memoranda, publications, manuals or other documents reflecting or referring to the Company's policies, procedures or guidelines concerning the 2004

> Rights Offering, including, without limitation, all policies, procedures, or guidelines concerning the receipt of subscriptions after the deadline;
>
> 7. All records reflecting or referring to 2004 Rights Offering subscriptions received after the subscription deadline;
>
> 8. All records reflecting or referring to 2004 Rights Offering notices of guaranteed delivery received after the deadline for such notices;
>
> 9. All records reflecting or referring to the number of 2004 Rights Offering subscriptions received at all times during the 2004 Rights Offering subscription period, including, without limitation, all calculations, tabulations, charts, running totals, spreadsheets, and raw data; and
>
> 10. All documents and other information provided by the subscription agent for the Company's class A shares concerning the number of 2004 Rights Offering subscriptions received and/or the number of oversubscription rights available at all times during the 2004 Rights Offering.
>
> 11. All records, including recorded phone conversation logs between the Company, its subscription agent, and any individual referencing or relating to the oversubscription rights.

Demand Ltr., Compl. Ex. A.

[*6] Deephaven stated four purposes for its demand: (1) to investigate possible corporate wrongdoing or mismanagement, including breaches of fiduciary duty, misuses of corporate assets, misuses of corporate information and/or other wrongdoing in connection with the handling of the 2004 Rights Offering; (2) to investigate and assess the veracity and legality of UGC's public and private disclosures made in connection with the 2004 Rights Offering; (3) to determine whether the rights of Deephaven and other similarly situated stockholders of UGC were impermissibly interfered with or denied by UGC or its agents in connection with the 2004 Rights Offering; and (4) to determine whether Deephaven and other similarly situated stockholders are in fact entitled to additional oversubscription privileges in connection with the 2004 Rights Offering. [9]

9 *Id.* at 3.

Following UGC's receipt of the Demand Letter, Deephaven and UGC engaged in some discussions in an attempt to resolve Deephaven's demand. [10] When Deephaven **[*7]** concluded the discussions would not be fruitful, it filed its Complaint. UGC then moved to dismiss.

10 Plaintiff's Answering Brief ("PAB") at 31.

II. ANALYSIS

A motion to dismiss under Rule 12(b)(6) will be granted where it appears with reasonable certainty that the plaintiff cannot prevail on any set of facts that can be inferred from the pleadings. [11] Plaintiff is entitled to all reasonable inferences that can be drawn from the Complaint. UGC advances a number of grounds, both procedural and substantive, for its motion to dismiss. The main arguments are discussed below.

11 *E.g., Leonard Loventhal Account v. Hilton Hotels Corp.*, 2000 Del. Ch. LEXIS 149, at *11 (Oct. 10, 2000).

A. Alleged Procedural Deficiencies

1. Proof of beneficial ownership

UGC argues that Deephaven's Complaint fails **[*8]** to satisfy *8 Del. C. § 220(b)*, because it does not include documentary evidence establishing its purported beneficial ownership of UGC stock.

Section 220(a)(2) provides in pertinent part that: " Stockholder' means a holder of record of stock in a stock corporation, or a person who is the beneficial owner of shares of such stock held either in a voting trust or by a nominee on behalf of such person. . . ." *Section 220(b)* further provides:

> In every instance where the stockholder is other than a record holder of stock in a stock corporation or a member of a nonstock corporation, the demand under oath shall state the person's status as a stockholder, be accompanied by documentary evidence of beneficial ownership of the stock, and state that such documentary

> evidence is a true and correct copy of what it purports to be.

Deephaven's Complaint specifically refers to its March 24, 2004 Demand letter. [12] The Demand Letter states that Deephaven and its parent are the beneficial owners of class A common stock of UGC held by Barclays. In addition, the letter states: "Attached collectively as Exhibit "A" are true and correct copies of Barclays account **[*9]** statements for Deephaven, reflecting Deephaven's beneficial ownership of the Company's shares on January 21, 2004, February 17, 2004 and March 24, 2004." Admittedly, the copy of the Demand Letter attached to the Complaint does not include any exhibits. A reasonable inference, however, is that the original of the letter sent to UGC did include the referenced Exhibit A. [13]

12 Compl. PP 11-13.

13 UGC presented no argument or evidence to suggest that the original Demand Letter did not include the referenced Exhibit A.

The legal premise of UGC's argument is wrong. UGC contends that *8 Del. C. § 220* requires that Deephaven's Complaint include documentary evidence of its alleged beneficial stock ownership as prescribed in *§ 220(b)*. The Court disagrees. *Section 220(b)* specifies the requirements for a demand letter where the stockholder is other than a record holder. Notably, UGC does not allege that the documents attached to Deephaven's March 24, 2004 Demand Letter were insufficient. **[*10]** Rather, it relies on its suspicion of Deephaven's motives and of the possibility that whatever stock "position" it had with Barclays may have been a short position, and not an ownership position.

UGC can explore its suspicions at trial. They do not provide a basis for dismissal under Rule 12(b)(6). The allegations of beneficial ownership in Deephaven's Complaint and its attached Demand Letter suffice to defeat UGC's motion to dismiss for insufficient proof of ownership.

2. Power of attorney authorizing plaintiff's counsel to conduct inspection

Section 220(b) provides that:

> In every instance where an attorney or other agent shall be the person who seeks the right to inspection, the demand under oath shall be accompanied by a power of attorney *or other such writing* which authorizes the attorney or other agent to so act on behalf of the stockholder.

(Emphasis added).

UGC claims that, because attorneys for Deephaven would be reviewing the documents, *§ 220* requires a power of attorney. Deephaven argues that since it, and not its counsel, demanded the inspection, no power of attorney had to accompany its demand.

In *Henshaw v. American Cement Corp.* **[*11]** , this Court held that:

> A power of attorney is required under *§ 220(b)* only when an attorney or agent *makes* the demand. Implicit in the statute is a requirement that when inspection is to be made by a person other than the stockholder, the corporation be given evidence of his authority to so act. In this case Henshaw's demand, under oath, met that requirement by naming his agents and attorneys who were to make the inspection. [14]

Similarly, Deephaven's Demand Letter in this case met the authorization requirement of *§ 220(b)*. The *Mattes* case [15] relied upon by UGC is not inconsistent with this conclusion, because in *Mattes* the demand was made by an attorney purporting to act for the stockholder. Thus, the Court rejects UGC's challenge to Deephaven's *§ 220* action based on the absence of a power of attorney.

14 *252 A.2d 125, 128 (Del. Ch. 1969)* (emphasis in original).

15 *Mattes v. Checkers Drive-In* Restaurants, Inc., 2000 Del. Ch. LEXIS 163, 2000 WL 1800126, at *1 (Del. Ch. Nov. 15, 2000).

[*12] 3. "Under penalty of perjury" requirement

A demand for inspection under *§ 220* must be made in writing and "under oath." [16] "'Under oath' includes statements the declarant affirms to be true under penalty of perjury under the laws of the United States or any state." [17] UGC argues that because Deephaven's demand does not aver that the statements therein are true "under penalty of perjury," it fails to comply with the statute. Deephaven responds that there is no requirement that the demand actually contain the words "under penalty of perjury," and that its demand is sufficient because it is

notarized and therefore subject to penalty of perjury by definition.

16 *8 Del. C. § 220(b)*
17 *8 Del. C. § 220(a)(4)* (adopted in 2003).

This Court has held that the signature of a notary, absent any language indicating an oath or affirmation, is insufficient to fulfill the "under oath" requirement of *§ 220*. [18] Deephaven's demand, however, contains **[*13]** a verification "under oath that the [statements therein are] true and accurate," signed by a Deephaven representative with a notation signed by a notary that it was "sworn to and subscribed before" him. [19] Such a verification clearly fulfills the "under oath" requirement of *§ 220*. Indeed, UGC's argument to the contrary borders on frivolous. [20] At best, it misreads *§ 220(a)(4)* to require that statements in a demand must be affirmed to be true under penalty of perjury. To the contrary, the Court reads that section's use of "includes" to authorize use of an affirmation under penalty of perjury *as an alternative* to swearing an oath before a notary public in the more traditional sense.

18 *Frank v. Libco Corp., 1992 Del. Ch. LEXIS 253 (Dec. 8, 1992).*
19 Demand Ltr., Compl. Ex. A.
20 *See* 2 D. Drexler, L. Black, A.G. Sparks, *Delaware Corporation Law and Practice, § 27.02* n.8. ("Prior to 2003 [when the statute was amended], the demand to be made "under oath" (*i.e.*, notarized), and technical defenses based on the requirement were occasionally made, albeit unsuccessfully.")

[*14] Based on the foregoing, none of the procedural grounds for UGC's motion to dismiss have merit.

B. Challenges to Deephaven's Purpose

UGC further claims the Complaint should be dismissed because Deephaven's purpose for seeking inspection relates to its interest as a rightsholder, not as a stockholder. In the Rights Offering, UGC distributed to stockholders 0.28 rights for each share of UGC Class A common stock they owned. The rights were transferable, and carried with them oversubscription rights for those rightsholders who chose to exercise their basic subscription privilege. [21] As noted, UGC claims that Deephaven acquired its subscription rights from other stockholders, without obtaining the underlying shares. [22] Deephaven seeks to investigate whether it should have been entitled to additional oversubscription rights. UCG claims that purpose is not proper, because it does not relate to Deephaven's interest as a stockholder, but rather only to its interest as a rightsholder.

21 Jefferis Cert. Ex. A; Compl. PP 5, 7.

22 Based on the allegations in the Complaint, the Court assumes for purposes of UGC's motion to dismiss that Deephaven was the beneficial owner of at least some UGC stock at all relevant times.

[*15] 1. Standards

Section 220 requires that a stockholder seeking inspection of books and records state a proper purpose for the inspection. UGC contends that Deephaven's purpose for seeking inspection is not proper.

Section 220 defines a "proper purpose" as one "reasonably related to [the requesting] person's interest as a stockholder." It is the corporation's burden to demonstrate that a plaintiff does not have a proper purpose for seeking inspection of stocklists. [23] In contrast, it is the stockholder's burden to establish that she has a proper purpose for seeking to inspect books and records other than stocklists. [24]

23 *8 Del. C. § 220(c); Compaq Computer Corp. v. Horton, 631 A.2d 1, 3 (Del. 1993).*
24 *8 Del. C. § 220(c). E.g., Thomas & Betts Corp. v. Leviton Mfg. Co., 685 A.2d 702, 715 (Del. Ch. 1995), aff'd, 681 A.2d 1026 (Del. 1996).*

In order to demonstrate a proper purpose **[*16]** when seeking to investigate possible mismanagement, a stockholder must "present some credible basis from which the Court can infer that waste or mismanagement may have occurred." [25] Stockholders are not required to show actual mismanagement, but they must show, by a preponderance of the evidence, that there is a possibility of mismanagement. [26] Stockholders cannot satisfy this burden merely by expressing disagreement with a business decision. [27] When a business judgment forms the basis of a request for books and records, a stockholder must show a credible basis for an inference that management suffered from some self-interest or failed to exercise due care in a particular decision. [28]

25 *Thomas & Betts, 681 A.2d at 1031.*
26 *Id.; Sec. First Corp. v. U.S. Die Casting & Dev. Co., 687 A.2d 563, 565 (Del. 1997).*
27 *Everett v. Hollywood Park, Inc.*, 1996 Del. Ch. LEXIS 2, 1996 WL 32171, at *5-6 (Del. Ch. Jan. 19, 1996)(rejecting challenges to business judgments without a credible basis from which the Court could infer self-dealing or failure to exercise due care).

[*17]

28 *Id.; Weiland v. Cent. S.W. Corp.*, 1989 Del. Ch. LEXIS 48, 1989 WL 48740, at *2 (Del. Ch. May 9, 1989)(dismissing *§ 220* action for failure

to allege facts from which court could infer a lack of independence or failure to exercise due care).

The Delaware Supreme Court has encouraged the use of a *§ 220* action to meet the specificity requirements of Court of Chancery Rule 23.1 before filing a derivative suit. [29] The Court also has noted, however, that its encouragement of stockholders to file *section 220* actions before filing a derivative suit has not eviscerated or modified the need for a stockholder to show a proper purpose for a request under *§ 220*. [30]

29 *See, e.g., Scattered Corp. v. Chicago Stock Exch., 701 A.2d 70, 78 (Del. 1997); Rales v. Blasband, 634 A.2d 927, 935 n.10 (Del. 1993).*
30 *E.g., Thomas & Betts, 681 A.2d at 1031 n.3.*

2. The record [*18] on UGC's motion to dismiss

As a threshold matter, the parties disagree about what the Court may consider on UGC's motion to dismiss. Specifically, UGC argues that the following categories of documents are integral to the Complaint or incorporated in it by reference: (a) the Rights Offering; (b) the February 13 and 20, 2004 press releases; (c) the pre-demand correspondence; and (d) various documents related to the parties' settlement negotiations. [31] Deephaven objects that UGC is attempting to "prematurely argue factual issues relating to the underlying merits of the claimed wrongdoing by inappropriately and selectively injecting a host of documents and materials well outside of the pleadings." [32]

31 *See* DOB App. A.
32 PAB at 1.

In particular instances and for carefully limited purposes, this Court may consider documents referred to in a complaint when ruling on a motion to dismiss. [33] In the *Sante Fe* case, for example, the Delaware Supreme Court held that the Court of Chancery properly [*19] considered a Joint Proxy Statement in connection with plaintiffs' nondisclosure claims, but not with respect to their *Revlon* [34] and *Unocal* [35] claims. For the latter claims, the Court ruled that the Joint Proxy Statement amounted to hearsay and could not be relied upon for the truth of the matters discussed in it. [36]

33 *See In re Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 69 (Del. 1995).*
34 *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).*
35 *Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).*
36 *Santa Fe, 669 A.2d at 68-70.*

(a) The rights offering

The Complaint repeatedly refers to the Rights Offering. In addition, Deephaven bases its claim for inspection of UGC's books and records primarily on allegations that UGC may have violated the terms of the Rights Offering. Since the Rights Agreement is integral to, and referred to in the Complaint, the Court [*20] will consider it in connection with UGC's motion.

(b) The press releases

Similarly, the Complaint refers to two press releases issued by UGC, one on February 13 and the other on February 20, 2004. Deephaven relies on these press releases to support its claim of a proper purpose. Accordingly, the Court will consider them, but solely as evidence of what the releases stated. To the extent UGC relies on those documents for the truth of what is stated in them, they are hearsay and will not be considered.

(c) Pre-demand correspondence

The Complaint refers to and includes as an attachment the March 24, 2004 Demand Letter. Both parties agree that the Demand Letter is part of the record. The only other correspondence referred to in the Complaint is a February 24, 2004 letter from Deephaven's counsel, Mr. Reed, to UGC. If necessary, the Court will consider that document on the motion to dismiss.

UGC argues, however, that five other pieces of correspondence between March 1 and March 24, 2004 also should be deemed part of the record. The reason is that they are referenced in the Demand Letter. Because these documents are at most only tangentially related to the issues presented [*21] in the Complaint and UGC's motion to dismiss, the Court finds it unnecessary to consider them.

(d) Settlement negotiations

In a transparent attempt at overreaching, UGC seeks to include in the record on its motion to dismiss a string of emails reflecting the parties' settlement discussions and the selected documents UGC offered to produce in settlement. Deephaven never agreed to accept that offer. To support consideration of these documents, UGC argues that Deephaven "opened the door" to them by referring to the settlement discussions in the Complaint.

The sole reference to settlement discussions in the Complaint (P 14) reads:

> 14. Following Deephaven's service of the Demand letter, counsel for the Company and counsel for Deephaven had some discussions regarding the possibility of an informal resolution of Deephaven's Demand, however, it became apparent to Deephaven that such discussions would

> prove unfruitful, thus prompting the filing of this action.

This passing and very general reference to settlement discussions provides no basis for concluding that those discussions are integral to the Complaint or otherwise should be considered. Therefore, the Court will **[*22]** exclude all of the documents related to a possible settlement proffered by UGC from consideration on its motion to dismiss.

3. Whether the Complaint should be dismissed for lack of a proper purpose

Relying on *Lynn v. Envirosource*, [37] UGC contends that Deephaven's purpose is not related to its interest as a stockholder and is therefore not a proper purpose under *8 Del. C. § 220*. In *Lynn*, the stockholder sought access to company records to obtain evidence for use in an age discrimination case he had filed against the company. To determine whether that purpose was reasonably related to Lynn's interests as a stockholder, the Court asked whether it was something a stockholder would be interested in based on its position as a stockholder. The Court held that Lynn's purpose had nothing to do with his status as a stockholder; instead, it stemmed from his status as a litigant before a different tribunal. [38] Thus, the Court granted summary judgment against Lynn based on the absence of a proper purpose for his *§ 220* demand.

37 1991 Del. Ch. LEXIS 86, 1991 WL 80242, at *2 (Del. Ch. May 13, 1991).

[*23]

38 *Id.*

UGC analogizes Deephaven's purpose to Lynn's by arguing that only those stockholders who also happened to be rightsholders who had exercised their basic subscription privileges would be interested in the records Deephaven seeks to inspect. [39] Deephaven responds that since the subscription rights associated with the Rights Offering were made available only to holders of UGC stock and were for shares of UGC stock, the distribution of those rights "necessarily involves and affects the rights and interests of the Company's stockholders." [40]

39 DOB at 23.

40 PAB at 19.

Even assuming that not all UGC stockholders would share Deephaven's interest in the requested documents, the *Lynn* case is readily distinguishable. There, as the Court recognized, it was very unlikely that *any* other stockholders would share Lynn's purpose, because it was so tied to his specific circumstances and only coincidentally **[*24]** had anything to do with his stock in the defendant. Here, it is reasonable to infer that at least some other stockholders of UGC will share Deephaven's interest because of their position as stockholders. The Rights Offering was made to UGC stockholders. Most likely some of the other stockholders not only obtained and fully exercised subscription rights under the Rights Offering to obtain UGC stock, but also pursued their oversubscription privileges. Such stockholders probably would be interested in determining why the available oversubscription rights decreased as much as they did. Those oversubscription privileges would have entitled the holders to more UGC stock. Similarly, at this preliminary stage, the Court cannot rule out the possibility that other stockholders would share Deephaven's suspicions of mismanagement, dilution, preferential treatment or selling to insiders.

UGC also challenges Deephaven's purpose as being adverse to the interests of UGC. Such adversity of interest could render a stockholder's purpose improper. [41] UGC argues that Deephaven's ultimate purpose is to force UGC to issue 18 million additional subscription rights at the discounted price available through **[*25]** the Rights Offering ($ 6.00). [42] Since the market price of the stock is considerably higher, UGC argues, such an issuance would be adverse to UGC and its stockholders.

41 *See Catalano v. T. W.A.*, 1977 WL 2576, at *2 (Del. Ch. Nov. 3, 1977).

42 DOB at 24.

On the limited record currently before the Court, this argument lacks merit for several reasons. First, the Court has difficulty accepting the argument that UGC and its stockholders would be harmed if it had to comply with its obligations under the Rights Offering and any related fiduciary duties. UGC presumably made the Rights Offering for its own benefit and that of its stockholders, to whom the offering was made. It cannot complain if a holder of both stock and rights takes steps to ensure that UGC adhered to its part of the bargain.

Second, Deephaven has asserted other purposes besides compelling the sale of additional subscription rights. Deephaven also seeks, for example, to investigate whether UGC engaged in mismanagement **[*26]** or wrongdoing in connection with the initial rights offering. When a stockholder has made out a proper purpose, the propriety *vel non* of another, secondary purpose is irrelevant. [43] Furthermore, the fact that mismanagement might give rise to UGC's liability to a class of stockholders does not render Deephaven's purpose improper. It is well-settled that the possibility of harm to a corporate defendant is insufficient to deny relief under *§ 220*. [44]

43 *Skoglund & Ackerly v. Ormand Indus., 1976 Del. Ch. LEXIS 155, at *2 (Dec. 3, 1976).*

44 *Compaq, 631 A.2d at 4.* The Court also noted that "insofar as law and policy require corporations and their agents to answer for the breaches of their duties to shareholders, Compaq has no legitimate interest in avoiding the payment of compensatory damages which it, its management or advisors may owe to those who own the enterprise." *Id.*

4. Challenges to evidence of possible misconduct

Investigation of mismanagement **[*27]** is a proper purpose under *§ 220*, [45] but the party seeking access to the records must "present some credible basis from which the Court can infer that waste or mismanagement may have occurred." [46] Here, Deephaven's suspicions of mismanagement derive from what it characterizes as a sudden, material change in the amount of oversubscription rights available, despite the fact that contradictory information was provided to Deephaven representatives in contemporaneous conversations they allegedly had with representatives of UGC and its subscription agent, Mellon. To rebut those allegations, UGC advances three arguments: (1) Deephaven has not identified specific actions of any officials of UGC; (2) the terms of the Rights Offering insulate it from liability; and (3) Deephaven's allegations relating to the change in the availability of rights are not credible. For the reasons stated below, none of these arguments warrants dismissal of Deephaven's *§ 220* action at the pleading stage.

45 *Sec. First Corp. v. U.S. Die Casting & Dev. Corp., 687 A.d 563, 567-69 (Del. 1997).*
46 *Thomas & Betts, 681 A.2d at 1031.*

[*28] The Court rejects UGC's argument that Deephaven had an obligation to identify specific actions of specific officials of the Company to meet is pleading burden under *8 Del. C. § 220*. UGC failed to cite any support for such a requirement, and the Court knows of none. *Section 220* is a summary proceeding, and this contention can best be addressed after the factual record is developed at trial.

In support of its argument that the Rights Offering insulates it from liability, UGC points to language in it that authorized UGC, in its sole discretion, to permit untimely subscriptions, notices and deliveries. Thus, UGC argues that even if it had accepted late submissions (which it denies), it had the right to do so. Deephaven counters that, even if UGC's management had a right to waive the deadlines in the Rights Offering, they would have had to exercise that right within the constraints of their fiduciary obligations to all stockholders. In addition, whether and under what circumstances UGC may have waived deadlines under the Rights Offering goes to the merits of the underlying dispute. Based on the briefing and argument, the Court concludes that UGC's arguments **[*29]** as to its right to waive deadlines raise issues of fact regarding the meaning of the Rights Offering, the attendant fiduciary duties and the actions taken by UGC that simply cannot be resolved on a motion to dismiss.

In questioning the credibility of Deephaven's allegations relating to the availability of rights, UGC points to the February 13 and 20, 2004 press releases as supplying explanations for the drop in the number of available oversubscription rights. In that regard, the Court is mindful of the Delaware Supreme Court's caution that in the context of a motion to dismiss, it should "not employ assertions in documents outside the complaint to decide issues of fact against the plaintiff without the benefit of an appropriate factual record." [47] Contrary to UGC's suggestion, the cited press releases are not conclusive evidence of the truth of the statements contained in them. Likewise, the Court is skeptical of the hearsay allegations that provide the basis for Deephaven's contention that the allegations in its Complaint provide a credible basis for inferring possible "claims of breach of fiduciary duty, including mismanagement of corporate assets, waste and stockholder discrimination, **[*30]** by improperly depriving or interfering with the rights of Deephaven and other similarly situated shareholders." [48] At trial, Deephaven will have the burden to prove that it has satisfied the proper purpose requirement of *§ 220* by making a credible showing, through documents, logic, testimony or otherwise, that there are legitimate issues of wrongdoing. [49] At this stage, however, the Court cannot conclude that Deephaven clearly will not be entitled to any relief under *§ 220* under any set of facts that could be proven based on the allegations in its Complaint. Accordingly, there is no basis to dismiss Deephaven's Complaint under Rule 12(b)(6) for inability to prove a proper purpose.

47 *White v. Panic, 783 A.2d 543, 547 n.5 (Del. 2001).*
48 PAB at 21.
49 *Sec. First, 687 A.2d at 568.*

III. CONCLUSION

For the reasons stated above, UGC's Motion to Dismiss is DENIED.

IT IS SO ORDERED.

TAB 3

LEXSEE 2006 DEL. CH. LEXIS 182

ENERGY PARTNERS, LTD., a Delaware corporation, Plaintiff, v. STONE ENERGY CORPORATION, a Delaware corporation, Defendant. Civil Action No. 2402-N; ATS, INC., a Delaware corporation, Plaintiff, v. RICHARD A. BACHMANN, JOHN C. BUMGARNER, JR., JERRY D. CARLISLE, HAROLD D. CARTER, ENOCH L. DAWKINS, NORMAN C. FRANCIS, ROBERT D. GERSHEN, PHILLIP A. GOBE, WILIAM R. HERRIN, JR., WILLIAM O. HILTZ, JOHN G. PHILLIPS, ENERGY PARTNERS, LTD., a Delaware corporation, and STONE ENERGY CORPORATION, a Delaware corporation, Defendants. Civil Action No. 2374-N

Civil Action No. 2402-N, Civil Action No. 2374-N

COURT OF CHANCERY OF DELAWARE, NEW CASTLE

2006 Del. Ch. LEXIS 182

September 22, 2006, Submitted
October 11, 2006, Decided
October 30, 2006, Filed

NOTICE:

[*1] THIS OPINION HAS NOT BEEN RELEASED FOR PUBLICATION. UNTIL RELEASED, IT IS SUBJECT TO REVISION OR WITHDRAWAL.

SUBSEQUENT HISTORY: As Corrected November 2, 2006.

COUNSEL: Kevin G. Abrams, Esquire, J. Travis Laster, Esquire, ABRAMS & LASTER LLP, Wilmington, Delaware, Attorneys for Plaintiff Energy Partners, Ltd. in Civil Action No. 2402-N and for Defendants other than Stone Energy Corporation in Civil Action No. 2374-N.

Bruce E. Jameson, Esquire, PRICKETT, JONES & ELLIOTT, P.A., Wilmington, Delaware, Attorneys for Defendant Stone Energy Corporation in Civil Action Nos. 2402-N and 2374-N.

Edward P. Welch, Esquire, Edward B. Micheletti, Esquire, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, Wilmington, Delaware; Jay B. Kasner, Esquire, Scott D. Musoff, Esquire, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, New York, New York, Attorneys for Plaintiff ATS, Inc. in Civil Action No. 2374-N.

JUDGES: PARSONS, Vice Chancellor.

OPINION

MEMORANDUM OPINION

PARSONS, Vice Chancellor.

This matter is before the Court on two separate, but related Civil Actions, Nos. 2374-N and 2402-N, seeking declaratory judgment relief as to the meaning and validity of a provision of a merger agreement (Section 6.2(e)) between two oil and gas exploration companies, Energy Partners, Ltd. ("EPL") and Stone Energy Corporation ("Stone"). Stone, the target of the merger, is a defendant in both actions; [*2] EPL is the plaintiff in No. 2402. The plaintiff in the second action, ATS, Inc. ("ATS"), is another oil and gas company that made an unsolicited tender offer for EPL after EPL and Stone agreed to merge, but contingent on the merger not going forward ("ATS Tender Offer"). The tender offer commenced on August 31, 2006, and was set to expire on September 28, 2006. EPL and ATS (collectively, the "Plaintiffs") claim that under Stone's construction of Section 6.2(e), EPL would be precluded from engaging in numerous strategic activities, including communicating with ATS about its tender offer, that EPL must be able to pursue to satisfy its fiduciary and statutory duties to its stockholders. Plaintiffs therefore contest Stone's reading of Section

6.2(e) and, alternatively, claim it is invalid on its face because it impermissibly circumscribes the EPL directors' ability to perform their fiduciary duties. Stone denies Plaintiffs' allegations and has moved to dismiss their claims on the grounds that there is no actual controversy and the claims are not ripe.

The Court conducted an expedited trial on the Section 6.2(e) issues on September 22, 2006. The parties submitted the case on an agreed [*3] record and presented argument on the merits and on Stone's motion to dismiss at that time. Due to exigent circumstances, including the pendency of the ATS Tender Offer and the contemplated stockholders' vote on the Stone Merger Agreement, the Court set forth its determinations in a summary manner in an oral ruling on September 27, 2006 to provide clarity to the parties going forward. Those determinations are explicated in this memorandum opinion.

For the reasons stated, the Court concludes that Plaintiffs' claims are justiciable, but only to the extent they relate to EPL's ability to explore Third Party Acquisition Proposals as defined in the Stone Merger Agreement, including the ATS Tender Offer. In all other respects, the claims are dismissed without prejudice as premature. Regarding consideration of or negotiation as to Third Party Acquisition Proposals, the Court holds that such activity is outside the scope of the proscriptions of Section 6.2(e). Accordingly, Plaintiffs' contention that Section 6.2(e) is invalid on its face because it restricts such activity is moot.

I. BACKGROUND

A. The Parties

Plaintiffs are Energy Partners, Ltd., a Delaware corporation with [*4] its principal place of business in New Orleans, Louisiana, and ATS, Inc., a Delaware corporation, and an indirect wholly owned subsidiary of Woodside Petroleum Ltd. ("Woodside"), a listed Australian Company. [1] EPL is an independent oil and natural gas exploration and production company with current operations in the Gulf of Mexico. [2] ATS's parent, Woodside, is also an oil and gas exploration and production company with operations in eleven countries. [3] Defendant is Stone Energy Corporation, a Delaware corporation with its principal place of business in Lafayette, Louisiana. [4] Stone is also an independent oil and gas production company with operations located primarily in the Gulf of Mexico and the Rocky Mountain region. [5]

1 Joint Pretrial Order at 3.
2 *Id.* at 2-3.
3 *Id.* at 2.
4 *Id.* at 2.
5 *Id.* There are a number of additional defendants in No. 2374, but they are not involved in the declaratory judgment claims as to Section 6.2(e) currently before the Court.

[*5] B. Factual Background

These cases involve a series of proposed corporate acquisitions. The first occurred on April 23, 2006, when the Stone Board of Directors approved a merger agreement with Plains Exploration and Production Company ("Plains") under which Stone would merge into a wholly owned subsidiary of Plains. [6] The merger agreement ("Plains Merger Agreement") contained a "no-shop" provision applicable to Stone (but not to Plains) [7] and a "fiduciary out" provision that permitted Stone, after consultation with its legal and financial advisors, to investigate other unsolicited proposals that qualified as superior to the Plains transaction. [8] In the event of termination due to a superior proposal, Stone agreed to pay Plains a termination fee of $ 43.5 million. [9]

6 *Id.* at 3.
7 *Id.*
8 JX 14 at 63.
9 According to EPL, the Plains transaction had an aggregate equity value of approximately $ 1.46 billion based on the closing price of Plains common stock on April 21, 2006. EPL's Mot. to Dismiss at 2.

[*6] A month later, on May 25, 2006, EPL offered to acquire Stone for $ 52.00 in cash or EPL stock, subject to certain restrictions. [10] Upon receipt of this proposal, the Stone board determined that the proposal met the requisite fiduciary out provision in the Plains Merger Agreement and initiated negotiations with EPL. [11] The negotiations lasted three weeks. [12]

10 Joint Pretrial Order at 3.
11 EPL Opening Brief ("EOB") at 4; Stone Answering Brief ("SAB") at 7.
12 Joint Pretrial Order at 3-4.

On June 15, 2006, EPL submitted the final version of its merger agreement to Stone. [13] In broad terms, the agreement provided that Stone would merge with a wholly owned subsidiary of EPL, and Stone stockholders would receive $ 51.00 in cash or in EPL stock based on its 20-day average trading price, subject to a collar on the exchange ratio and ceilings on the amounts of stock and cash. [14] The Stone board approved the execution of the EPL merger and the related termination of the Plains Merger [*7] Agreement on June 22, 2006 ("Stone Merger"). [15] Pursuant to the Plains Merger Agreement termination clause, and as part of their merger agreement with Stone ("Stone Merger Agreement"), EPL agreed to

pay the $ 43.5 million termination fee on behalf of Stone to Plains. [16]

13 *Id.*
14 *Id.*
15 *Id.* at 4; JX 14 Stone Merger Agreement ("SMA") § 4.27.
16 *Farrington v. Bachmann,* C.A. No. 2416-N, Am. Class Action Compl. P 26.

C. The Stone Merger Agreement

In negotiating the Stone Merger Agreement, EPL and Stone used the Plains Merger Agreement as a model. [17] Relevant here, Section 6.2(e), the provision for which EPL and ATS seek a declaratory judgment, remained the same as in the Plains Merger Agreement. [18] Section 6.2(e), entitled "Conduct of Business by Parent [EPL] Pending the Merger," provides:

> Except as expressly permitted or required by this Agreement, prior to the Effective Time, neither Parent nor any of its Subsidiaries, without the prior **[*8]** written consent of Target, shall:
>
> (e) knowingly take, or agree to commit to take, any action that would or would reasonably be expected to result in the failure of a condition set forth in Sections 8.1, 8.2, or 8.3 [conditions to consummation of the merger] or (b) at, or as of any time prior to, the Effective Time, or that would reasonably be expected to materially impair the ability of Target, Parent, Merger Sub, or the holders of Target Common Shares to consummate the Merger in accordance with the terms hereof or materially delay such consummation.... [19]

In addition, the Stone Merger Agreement does not have an express "no-shop" provision restricting EPL's actions, but does contain a no-shop provision constraining actions by Stone. [20] The Stone Merger Agreement also provides that Stone, but not EPL, may terminate the merger if EPL, in reference to a "Third Party Acquisition Proposal," changes its recommendation for the Stone Merger. [21] The term Third Party Acquisition Proposal is defined under Section 10.1(i) as "an inquiry, offer or proposal" that is "conditioned upon the termination" of the Stone Merger Agreement and "abandonment" of the Stone Merger and in which **[*9]** the third party would acquire 30 percent or more of EPL. [22] Finally, the Stone Merger Agreement provides that if EPL's stockholders do not approve the Stone Merger in response to a Third Party Acquisition Proposal, EPL must pay Stone a $ 25.6 million termination fee. [23] The parties dispute how and why the merger came to be structured in this way.

17 Schuster Dep. at 12; Baden Dep. at 83-84.
18 Schuster Dep. at 19, 84-86; Baden Dep. at 83-84, 143-44.
19 SMA at 36.
20 SMA § 7.2.
21 SMA § 10.1(i).
22 *Id.*
23 SMA § 10.2(h).

D. ATS Hostile Tender Offer

After the signing of the Stone Merger Agreement, ATS announced a hostile tender offer for EPL on August 28, 2006. [24] The tender offer was for $ 23.00 per share and conditioned on the EPL stockholders voting down the Stone Merger Agreement. [25] On August 31, 2006, ATS formally launched the tender offer by filing its Schedule TO with the Securities and Exchange Commission. [26] With **[*10]** regard to Section 6.2(e), quoted in the Schedule TO, [27] ATS stated that Richard Bachmann, CEO of EPL, told Don Voelte, Woodside's CEO, during a conversation on August 28, 2006 that "under the terms of the Stone Energy Merger Agreement, [EPL] would not be able to deal with [ATS] while this agreement was in force." [28] Whether this was in fact said is disputed by EPL.

24 Joint Pretrial Order at 4.
25 *Id.* The Court notes that under Section 7.13(b) of the Stone Merger Agreement the EPL board is free to change its recommendation of the merger, but that the agreement includes a "force the vote" provision permissible under *8 Del C. § 251 (c)*. If the EPL stockholders vote down the increase in shares required to complete the merger, EPL would have to pay Stone a termination fee.
26 JX 16.
27 *Id.* at 27.
28 JX 16, ATS "Offer to Purchase" at 28; Schuster Dep. at 57-60, 112-14.

E. Stone and EPL Dispute Interpretation of Section [*11] 6.2(e) as it Relates to the ATS Tender Offer

Stone and EPL have expressed differing interpretations of Section 6.2(e). Stone's brief suggests that 6.2(e) is not a "no talk" or "no shop" provision. [29] Yet in Baden's deposition, he expressly states that even "negotiations between EPL, ATS, and Woodside could result in a violation of Section 6.2(e)." [30] Implicit in Stone's position

is that Section 6.2(e) does not unconditionally prevent EPL from talking; instead, the permissibility of any discussion, according to Stone, hinges on whether it would "reasonably be expected to impact the Stone Merger." [31] Stone reinforced the threat implied by their position by sending a reservation of rights letter to EPL concerning EPL's conduct up to September 18, 2006. [32] Having reviewed Stone's statements carefully, the Court concludes that, as a practical matter, Stone has conceded virtually nothing about the meaning of 6.2(e), not even that it permits EPL to talk to or negotiate with ATS.

29 SAB at 38. Like most of its apparent concessions, however, Stone effectively qualifies its statement by appending the language of 6.2(e) to it. The effect is to render the "concessions" illusory. For example, Stone states in its answering brief:

> EPL is free to engage in any such conduct *so long as* in doing so EPL does not knowingly take, or agree to commit to take, any action that would violate any of EPL's affirmative covenants under the Merger Agreement or *would reasonably be expected* to: (i) cause the failure of a condition of the EPL Merger; (ii) materially impair the ability of the parties to consummate the EPL Merger; or (3 [sic]) materially delay the consummation of the merger consistent with § 6.2(e). *Id.* (emphasis added).

[*12]

30 Baden Dep. at 148-49; *see also id.* at 35 (indicating that there may be situations where EPL could not even talk to ATS).

31 *See* Baden Dep. at 168-69 where he testified:

> [I]f the EPL board actively pursued a transaction which it knew would materially impair or delay the Stone transaction such as a merger with a third party conditioned upon the termination of the Stone merger agreement, and in approving that transaction also changed its recommendation, I believe that that transaction is in dire straits and could be deemed in violation of 6.2(e).

It is a small step from "such as a merger" to the ATS Tender Offer.

32 JX 23.

The Rule 30(b)(6) deponents, Alan Baden and John Schuster (outside counsel for Stone and EPL, respectively), engaged in a series of conversations about the meaning of Section 6.2(e) and Stone's position on the section. EPL's 14D-9 SEC filing characterized those discussions as follows: "Stone's outside counsel informed EPL's outside counsel that Stone did not concur with EPL's interpretation of the Merger Agreement and that Stone **[*13]** believed the Company was prohibited from communicating with Woodside regarding the Offer." [33] According to Schuster, Baden initially said there was not a "no shop" provision, but later reversed course and twice stated EPL could not talk to ATS. [34] Baden denies these allegations, but in the same breath says he does not recall whether he made the statements. [35] The facts reveal disagreement between the parties on this issue, which Stone's qualified representations to the Court have failed to dispel.

33 JX 11 EPL 14D-9 at 6.

34 Schuster Dep. at 55-57; *see also* JX 13.

35 Baden Dep. at 116.

The evidence also demonstrates that although EPL wants to talk to ATS about the tender offer, Stone's position on Section 6.2(e) has deterred EPL from doing so. [36] Likewise, ATS wishes to engage in discussions with EPL. [37]

36 Schuster Dep. at 110, 131-32.

37 September 22, 2006 Hearing Transcript ("Sept. 22 Tr.") at 45, 49.

[*14] F. The Parties' Contentions

In C.A. No. 2402, EPL argues that 6.2(e) was not intended to be, and cannot be construed to be, a no-shop clause. [38] During the negotiations Stone proposed a reciprocal no-shop clause (with a fiduciary out) restricting EPL that EPL rejected. Stone acquiesced on that point. [39] EPL further argues that 6.2(e) cannot apply to what it calls "Strategic Alternative Transactions." [40] ATS argues that 6.2(e) is invalid to the extent it "prevents the EPL directors from fulfilling their fiduciary duties" and that it should be declared void as a matter of law and public policy. [41] Stone, through its briefs, depositions, and oral argument takes the position that 6.2(e) means what it says, but does not operate to restrict EPL so long as any

negotiations, recommendations, or third party agreement does not materially delay or impair the Stone Merger. [42] Stone maintains that the absence of an additional provision that would have enabled EPL to terminate the merger based on a third party transaction resulted from Stone's desire for "deal certainty." [43] Yet, the parties have stipulated that:

> During the negotiation of the [EPL-Stone] Merger Agreement, **[*15]** neither side commented on or mentioned Section 6.2(e) in their negotiations with each other.

And that:

> During the negotiation of the Plains Merger Agreement, there had been no discussion or negotiation regarding Section 6.2(e) between Plains and Stone. [44]

EPL therefore contends that Stone is trying to engraft new meaning on Section 6.2(e) that is not supported by the language of the agreement or the negotiating history.

38 EOB at 17.
39 Joint Pretrial Order at 3.
40 EOB at 26-29.
41 ATS Reply Br. ("ARB") at 11.
42 SAB at 13-14.
43 Sept. 22 Tr. at 62-63. An early draft of the Stone Merger Agreement contained a provision 10.1(j) that would have permitted Stone *or* EPL to terminate the agreement in response to a third party proposal. JX 2 at 50. The expedited trial on September 22 did not include Plaintiff Farrington's claims in a third related suit described *infra* that the absence of a reciprocal right on the part of EPL to terminate the agreement is problematic.
44 Joint Pretrial Order at 3-4.

[*16] G. Procedural History

On August 28, 2006, ATS, in its capacities as a shareholder of EPL and the bidder in a hostile tender offer, filed a Complaint seeking injunctive and declaratory relief against EPL, Stone, Richard Bachmann, as Chair and CEO of EPL, and EPL's other directors. The ATS complaint alleges, among other things, that the combined termination fees from the Plains Merger and Stone Merger amount to improper penalties, are *per se* invalid based on their coercive effect and constitute a breach of fiduciary duties. [45] ATS also asserts several director breach of fiduciary duty claims [46] and that Stone has aided and abetted the EPL directors in their breach of fiduciary duty. [47] The following day, ATS moved to expedite their case and sought an immediate trial on the merits. I held a brief teleconference to clarify the issues on that motion on September 6, 2006.

45 Complaint for Injunctive and Declaratory Relief ("ATS Compl."), at PP 20-30, 40-44. ATS's complaint also alleged that Section 2.9 of EPL's bylaws imposed a supermajority requirement on any actions taken by written consent, in violation of *Section 228* of the Delaware General Corporation Law ("DGCL"). *Id.* at PP 31-36, 46-50. The EPL board recently amended Section 2.9 of its bylaws, thereby mooting this aspect of the ATS Complaint. *See* Letter from Edward Micheletti, on behalf of ATS, to the Court (Sept. 18, 2006).

[*17]

46 *Id.* at PP 37,51-60.
47 *Id.* at PP 61-64.

On September 7, 2006, EPL filed an action for declaratory relief against Stone pertaining to Section 6.2(e) of the Stone Merger Agreement. [48] In its complaint, EPL seeks a declaratory judgment that Section 6.2(e) does not prohibit EPL from "soliciting, initiating, or encouraging from any person any inquiry, offer, or proposal that is reasonably likely to lead to a merger, consolidation, or other type of acquisition of [EPL], including discussing with third parties unsolicited acquisition proposals." [49]

48 Complaint for Declaratory Relief in No. 2402-N ("EPL Compl."), at PP 14-17.
49 Prayer for Relief P (a).

On September 11, 2006, Stone answered the EPL Complaint and moved to dismiss it on ripeness grounds. That same day, ATS amended its Complaint to add, among other things, a claim for a declaratory judgment that Section 6.2(e) of the **[*18]** Stone Merger Agreement is invalid *per se.* ATS also requested consolidation of its and EPL's cases, pursuant to Chancery Rule 42(a). After hearing argument on both motions on September 12, I granted the motion to consolidate on the narrow issue of Section 6.2(e) and took Stone's motion to dismiss under advisement for further consideration in connection with an expedited trial on the merits of the 6.2(e) issues to be held on September 22, 2006.

On September 12, 2006, Thomas Farrington, a stockholder of EPL, filed a complaint against Bachmann, the EPL directors, EPL, and Stone in his individual capacity and as a class action pursuant to Chancery Rule 23, seeking a declaratory judgment that the termination fees and several provisions of the Stone Merger Agreement are invalid and void, an injunction against the Stone Merger and any special meeting of EPL stock-

holders regarding it, as well as other relief. [50] Thereafter, Farrington filed a Motion to Expedite and Coordinate Proceedings ("Farrington Motion") and sought to participate in the September 22 trial. Stone and EPL opposed the Farrington Motion. In a conference on September 18, 2006, I granted the motion to the extent of directing **[*19]** the parties to coordinate pretrial activities in all three actions, but declined to include the Farrington claims in the September 22 proceedings on the Section 6.2(e) issue, because the class action complaint raises a number of different issues.

50 *Thomas Farrington v. Richard A. Bachmann, et al.*, C.A. No. 2416 (Del. Ch. Sept. 12, 2006).

Accordingly, I held a final hearing on the claims by EPL and ATS relating to the construction and validity of Section 6.2(e) of the Stone Merger Agreement on September 22. I also heard further arguments on Stone's motion to dismiss for lack of justiciability at the same time.

After the September 27 oral ruling, EPL submitted a letter to the Court, requesting "clarification" of two aspects of the ruling. The request amounts to a motion for reargument under Rule 59(f). [51] Specifically, EPL seeks clarification on the permissibility of "negotiation" with offerors of third party acquisition proposals and "solicit[ation]" of potential acquisition proposals. On October **[*20]** 4, Stone submitted its reply in which it consented to the inclusion of "negotiation" in the activities EPL can engage in pertaining to third party acquisition proposals, as defined in the Stone Merger Agreement. Stone objected, however, to the inclusion of "solicit" among the activities EPL could engage in on the ground that the Court already had ruled that EPL's claim on that issue is not ripe. In addition to explaining more fully the Court's September 27 oral ruling, this memorandum opinion also addresses EPL's request for reargument.

51 Court of Chancery Rule 59(f), entitled "Reargruments," states that such a motion may be served and filed within five days after the filing of the Court's opinion or receipt of the Court's decision, which has been met here.

II. ANALYSIS

A. Legal Standard for a Declaratory Judgment

Parties to a contract can seek declaratory judgment to determine "any question of construction or validity" and can seek a declaration of "rights, status or other legal relations **[*21]** thereunder." [52] The Declaratory Judgment Act enables the courts to advance the stage at which a matter traditionally would have been justiciable, [53] allowing for the construction of a contract before or after a breach has occurred. [54] It is in this sense that declaratory relief is in the discretion of the Court and not available as a matter of right. [55]

52 *10 Del. C. § 6502.*

53 *Rollins Int'l, Inc. v. Int'l Hydronics Corp., 303 A.2d 660, 662 (Del. 1973). See also Horizon Pers. Commc'ns, Inc. v. Sprint Corp., 2006 Del. Ch. LEXIS 141, 2006 WL 2337592, at *20 (Del. Ch. Aug. 4, 2006)* (stating that one of the purposes of the Declaratory Judgment Act is so that parties may determine a controversy as to the interpretation of a contract provision before the time that an ordinary civil action for a monetary judgment would occur (quoting *Pan Am. Petroleum Corp. v. Cities Serv. Gas Co., 382 P.2d 645, 649 (Kan. 1963)).*

54 *10 Del. C. § 6503.*

55

10 Del. C. § 6506 ("The court may refuse to render or enter a declaratory judgment or decree where such judgment or decree, if rendered or entered, will not terminate the uncertainty or controversy giving rise to the proceeding."); *Stroud v. Milliken Enters., Inc., 552 A.2d 476, 481 (Del. 1989).*

This Court also notes a split in authority as to who should bear the burden of persuasion. *See Am. Legacy Found. v. Lorillard Tobacco Co., 886 A.2d 1, 18 (Del. 2005)*; Wright, Miller & Kane, Federal Practice and Procedure: Civil 2d, § 2770. Consistent with the most recent decisions discussing this issue, in Delaware, "the better view is that a plaintiff in a declaratory judgment action should always have the burden of going forward." *Rhone-Poulenc v. GAF Chem., 642 A.2d 792, 1993 Del. Ch. LEXIS 49, at *7 (Del. Ch. Apr. 6, 1993)*; *see also Am. Legacy Found., 886 A.2d at 18.*

[*22] B. Legal Standard for Justiciability

For a dispute to be settled by a court of law, the issue must be justiciable, meaning that courts have limited their powers of judicial review to "cases and controversies." [56] Even though the Delaware Constitution does not have a direct analog to Article III's "case or controversy" requirement, the analysis is generally the same. [57] The Delaware Supreme Court has articulated four prerequisites that must be met for an "actual controversy":

> (1) It must be a controversy involving the rights or other legal relations of the party seeking declaratory relief; (2) it must be a controversy in which the claim

> of right or other legal interest is asserted against one who has an interest in contesting the claim; (3) the controversy must be between parties whose interests are real and adverse; (4) the issue involved in the controversy must be ripe for judicial determination. [58]

In this case, the first and fourth prerequisites of an actual controversy are disputed.

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U.S. CONST. art. III, § 2. The doctrinal limits of Justiciability not only stem from constitutional law, but also exist upon practical necessity. *See Poe v. Ullman, 367 U.S. 497, 503, 81 S. Ct. 1752, 6 L. Ed. 2d 989 (1961)* (observing that the "cases and controversies" limitation is based in part on the observation that the "adjudicatory process is most securely founded when it is exercised under the impact of a lively conflict between antagonistic demands, actively pressed, which make resolution of the controverted issue a practical necessity"); Erwin Chemerinsky, Federal Jurisdiction 43-124 (1989) (detailing the federal prohibition on advisory opinions, standing, ripeness, and mootness). "Concrete controversies [are] best suited for judicial resolution." *Id. at 40. See also Armstrong World Indus., Inc. v. Adams, 961 F.2d 405, 410 (3d Cir. 1992)* (prohibiting federal courts from issuing advisory opinions).

[*23]

57 *See Bebchuk v. CA, Inc., 902 A.2d 737, 740 (Del. Ch. 2006)* ("The Delaware courts have announced Justiciability rules that closely resemble those followed at the federal level."); *cf. Dover Historical Soc. v. City of Dover Planning Comm'n, 838 A.2d 1103, 1111 (Del. 2003)* ("This Court has recognized that the *Lujan* requirements for establishing standing under Article III to bring an action in federal court are generally the same as the standards for determining standing to bring a case or controversy within the courts of Delaware.") (citing *Oceanport Indus., Inc. v. Wilmington Stevedores, Inc., 636 A.2d 892, 904 (Del. 1994)).*

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Rollins, 303 A.2d at 662-63.

1. An actual controversy must exist for the case to be justiciable

An actual controversy must exist for declaratory judgment jurisdiction. [59] Delaware courts must "decline to exercise jurisdiction over cases in which a controversy has not yet matured," to avoid rendering advisory opinions. [60] The basic inquiry is whether the parties' conflicting **[*24]** contentions present a genuine and substantial controversy between parties having adverse legal interests. [61] In evaluating the justiciability of a declaratory judgment claim, a court must determine whether "the facts alleged, under all the circumstances, show that there is a substantial controversy... of sufficient immediacy and reality to warrant the issuance of a declaratory judgment." [62]

59 *See, e.g., Gannett Co. v. Bd. of Mgrs. for the Del. Crim. Just. Info. Sys., 840 A.2d 1232, 1237 (Del. 2003)* (stating broad rule).

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Stroud, 552 A.2d at 480 (quoting *Schick, Inc. v. Amalgamated Clothing & Textile Workers Union, 533 A.2d 1235, 1239 (Del. Ch. 1987)).* The Delaware Supreme Court underscores two policy reasons that are particularly relevant in this case. First, judicial resources are limited and to squander these resources on disagreements that may never ripen into a legal action creates an unwarranted impetus in future cases to seek judicial safety nets, wasteful of the Court's time and resources. Second, by rendering a judgment where the facts are not fully developed, a court not only runs the risk of granting a faulty judgment, but also of inappropriately and prematurely stepping into the development of law. *Id.*

[*25]

61 *Anonymous v. State, 2000 Del. Ch. LEXIS 84, 2000 WL 739252, at *4 (Del. Ch. June 1, 2000).*

62 *Step-Saver Data Sys., Inc. v. Wyse Tech., 912 F.2d 643, 647 (3d Cir. 1990)* (relying on *Md. Cas. Co. v. Pac. Coal & Oil Co., 312 U.S. 270, 273, 61 S. Ct. 510, 85 L. Ed. 826 (1941)).*

One argument Stone makes for dismissal is that certain aspects of this dispute are moot. The "actual controversy" requirement is the foundation for the mootness doctrine, which provides for dismissal of litigation if the alleged threatened injury no longer exists. [63] Similarly, if after the commencement of an action a party has been divested of standing, the mootness doctrine will render the proceeding unnecessary. [64] Accordingly, if, by virtue of post-filing events, the controversy no longer exists, a court generally cannot grant relief. [65] Two well-recognized exceptions to the mootness doctrine are: (1) where the issues are capable of repetition but likely to evade review; and (2) where the matter is of significant public importance. [66]

63 *See, e.g., Cal. Pub. Employee Ret. Sys. v. Coulter, 2005 Del. Ch. LEXIS 54, 2005 WL 1074354, at *3 (Del. Ch. Apr. 21, 2005)* (providing policy grounds for why a court should not resolve moot issues). This Court has often found a controversy moot when an imminent stockholder action has not yet occurred but would have the likelihood to render the matter moot. *See, e.g., Bebchuk, 902 A.2d at 742* (refusing to adjudicate a bylaw challenge because the stockholders had not yet voted); *Gen. Data Comm. Indus, v. Wis. Inv. Bd., 731 A.2d 818 (Del. Ch. 1999)* (same); *Diceon Elecs., Inc. v. Calvary Partners, L.P., 1990 Del. Ch. LEXIS 209, 1990 WL 237089 (Del. Ch. Dec. 27, 1990)* (same).

[*26]

64 *GMC v. New Castle County, 701 A.2d 819 at 823.*

65 *Id. at 823-24.*

66 *Glazer v. Pasternak, 693 A.2d 319, 320-21 (Del. 1997)* (identifying that a moot controversy does not mandate dismissal if the situation is capable of repetition but of evading review); *Gen. Motors Corp. v. New Castle County, 701 A.2d 819, 824 (Del. 1997)* (recognizing exception to the mootness doctrine for matters of public importance).

2. A case must be ripe to be justiciable

The Delaware Supreme Court has emphasized that the declaratory judgment statute must not be used as a means to elicit advisory opinions from the courts. [67] Even when, as here, the case involves the duties of a fiduciary, a court cannot issue an "adjudication of hypothetical questions." [68] Courts must make a "practical judgment" in determining whether an action is ripe. A court may find a case justiciable where the interest in postponing review until the question arises in a more concrete and final form is outweighed by the immediate and practical impact on the **[*27]** party seeking relief. [69] In making this determination, the willingness of parties to litigate is immaterial. [70]

67 *See, e.g., Ackerman v. Stemerman, 41 Del. Ch. 585, 201 A.2d 173, 175 (Del. 1964)* (emphasizing that courts will not entertain solicitation of advisory opinions and that there must be a factual situation in existence giving rise to immediate and inevitable litigation; *Stroud v. Milliken Enters., Inc., 552 A.2d 476, 479* (recognizing this caveat even in light of the adoption of the Declaratory Judgment Act).

68 *Rollins, 303 A.2d at 662*; *Wilmington Trust Co. v. Haskell, 282 A.2d 636, 639 (Del.Ch. 1971).*

69 *Stroud, 552 A.2d at 480* (quoting *Cont'l Air Lines, Inc. v. C.A.B., 173 U.S. App. D.C. 1, 522 F.2d 107, 124-25 (D.C.Cir. 1975)).*

70 *Stabler v. Ramsay, 32 Del. Ch. 547, 88 A.2d 546, 549 (Del. 1952).*

Worded differently, Plaintiffs must allege that "present harms will flow from the threat of future action. **[*28]** " [71] Thus, if a plaintiff's action is "contingent," that is, if "the action requires the occurrence of some future event before the action's factual predicate is complete," the controversy is not ripe. [72] Therefore, Plaintiffs must show that "the probability of that future event occurring is real and substantial, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment." [73]

71 *Presbytery of New Jersey of the Orthodox Presbyterian Church v. Florio, 40 F.3d 1454, 1463, 1466 (3d Cir. 1994)* (quoting *Bell Atlantic Corp. v. MFS Commc'ns Co., 901 F. Supp. 835, 843 (D. Del. 1995)).* Similarly, the Third Circuit held that the ripeness of a declaratory judgment action hinges on "the adversity of the interest of the parties, the conclusiveness of the judicial judgment and the practical help, or utility, of that judgment." *Step-Saver Data Sys., Inc., 912 F.2d at 647.*

72 *Bell Atlantic Corp., 901 F. Supp. at 843*; *Armstrong World Indus. v. Adams, 961 F.2d at 411-12*; *Wal-Mart Stores, Inc. v. AIG Life Ins. Co., 872 A.2d 611, 631-32 (Del. Ch. 2005)* (stating that if future events may obviate the need for declaratory relief, then the dispute is not ripe), *aff'd in pertinent part and rev'd in part, 901 A.2d 106 (Del. 2006).*

[*29]

73 *Anonymous v. State, 2000 Del. Ch. LEXIS 84, 2000 WL 739252, at *4* (citations and internal quotations omitted).

C. EPL and ATS's Contentions on Justiciability

ATS seeks a declaration that Section 6.2(e) of the Stone Merger Agreement, as construed by Stone, is invalid. Because EPL and Stone disagree on the interpretation of Section 6.2(e), ATS contends that the dispute concerning the validity of Section 6.2(e) is justiciable. [74]

74 In the preliminary submissions of the parties on the motions to expedite and consolidate, questions were raised as to ATS's standing. That issue could not be briefed, argued or considered in any depth or detail in these expedited proceedings regarding Section 6.2(e). Based on ATS's status

as a current stockholder of EPL, I have assumed for purposes of this opinion that it does have standing to challenge the validity of Section 6.2(e). *But see Omnicare, Inc. v. NCS Healthcare, Inc., 809 A.2d 1163, 1169 (Del. Ch. 2002).* The Court also notes that whether ATS has standing to pursue its bifurcated and deferred claims for breach of fiduciary duty as to Section 6.2(e) or the challenged termination fee provisions is the subject of motions to dismiss by EPL and Stone that the Court currently has under advisement.

[*30] EPL's argument is more complicated. First, EPL contends that as a matter of contract interpretation Section 6.2(e) does not apply to "Strategic Alternative Activities." EPL defines this term to include developing, soliciting, considering, communicating, exchanging information, negotiating, disclosing, entering into or consummating potential or definitive strategic alternatives. [75] Alternatively, EPL argues that if Section 6.2(e) applies to Strategic Alternative Activities, it operates as a "no-talk" provision or otherwise restricts the EPL Board's ability to fulfill their fiduciary duties, thereby rendering the provision *ultra vires* and void. [76]

75 EOB at 1. Many of these terms are drawn from § 10.1(i) (defining Third Party Acquisition Proposals) and § 7.2 (Stone no-shop provision) of the Stone Merger Agreement. *See* Sept. 22 Tr. at 8.

76 EOB at 2.

EPL also alleges that Stone's equivocation on the interpretation of Section 6.2(e) has prevented the EPL Board from even speaking with **[*31]** any third party offeror. The controversy surrounding Section 6.2(e), according to EPL, means that any correspondence its directors might have with ATS with respect to the ATS Tender Offer would subject the directors to substantial risk of a potential lawsuit by Stone. EPL alleges that the disputed language has created and continues to create a severe limitation on exploring the third party offer. Thus, EPL seeks to have this Court clarify the scope of Section 6.2(e) or invalidate it, so that the EPL board can explore the ATS and any other third party proposals that might arise and also pursue other Strategic Alternative Activities.

Stone argues that EPL and ATS have contrived an artificial dispute for adjudication. Stone maintains that Section 6.2(e) is not a "no-talk" or even a "no-shop" provision and that, so long as EPL does not take an action that fits within the plain language of Section 6.2(e), EPL will not be in breach of the Stone Merger Agreement. [77] Stone maintains that EPL is not "outright unconditionally precluded" from talking to ATS or any other party interested in acquiring EPL and therefore denies the existence of an "actual controversy." [78]

77 *See* Sept. 22 Tr. at 75-77. Stone contends that any alleged injuries that EPL has or may suffer are self-inflicted injuries. *See also id.* at 68-70 (Bruce Jameson, on behalf of Stone, responding to a hypothetical question, posited that a change in EPL director's recommendation with respect to the ATS Tender Offer, based on fiduciary duty obligations, would not be a breach of Section 6.2(e) ("[EPL has] recommended against it [the current ATS Tender Offer, but in the hypothetical would change their recommendation]. At that stage, Your Honor, I-I do not believe that would be a breach of 6.2(e).").

[*32]

78 SAB at 38.

Stone Further argues that EPL's purported need to discuss the ATS Tender Offer with ATS is moot. Stone bases this contention on EPL's filing of a Schedule 14D-9 with the SEC, recommending the rejection of the ATS Tender Offer. [79] In the 14D-9, EPL states that three separate investment banker opinions have found the current ATS tender to be financially inadequate. In response to EPL's position, ATS declined to increase the price of its tender offer. [80]

79 JX 11 at 8-9.

80 *Id.*; JX30.

In light of these arguments and the facts presented, the Court must evaluate two separate scenarios in terms of justiciability. First, Plaintiffs seek a determination of the applicability and validity of Section 6.2(e) as it pertains to Third Party Acquisition Proposals, as that term is defined in the Stone Merger Agreement. The ATS Tender Offer is an example of such a proposal. Second, EPL seeks a broader **[*33]** declaration as to its ability to explore and undertake Strategic Alternative Transactions.

1. Is there a justiciable dispute as to the impact of Section 6.2(e) on EPL's ability to explore Third Party Acquisition Proposals, such as the ATS Tender Offer?

As to EPL's ability to explore Third Party Acquisition Proposals, such as the ATS Tender Offer, the contentions of Stone regarding the import of Section 6.2(e) conflict with the positions of EPL and ATS. As EPL construes 6.2(e), it does not limit in any way EPL's ability to investigate the ATS Tender Offer and to communicate with ATS as the EPL Board sees fit. Stone denies that it contends Section 6.2(e) is either a no-shop or no-talk provision. Yet Stone's witness Baden testified that there are circumstances where negotiations between

EPL and ATS could result in a violation of 6.2(e). [81] Referring to a scenario that would include a transaction like the ATS Tender Offer, Baden stated:

> [I]f the EPL board actively pursued a transaction which it knew would materially impair or delay the Stone transaction such as a merger with a third party conditioned upon the termination of the Stone merger agreement, and in proving [*34] [sic: approving] that transaction also changed its recommendation [in favor of the Stone Merger], I believe that transaction is in dire straits and could be deemed in violation of 6.2(e). [82]

81 Baden Dep.at 148-49,35.
82 Baden Dep. at 168-69.

Based on this and other testimony, combined with the equivocal and highly qualified letters, briefs, and arguments of Stone's representatives, [83] the Court agrees with EPL and ATS that, notwithstanding Stone's denial that it construes 6.2(e) as a no-talk provision, a genuine controversy exists here between parties with adverse interests regarding EPL's ability to explore the ATS Tender Offer.

83 *See, e.g.,* Schuster Dep. at 49-50; JX 13 (correspondence between EPL's Schuster and Stone's Baden that reflect equivocation on Stone's position as to whether EPL can speak with ATS); Sept. 22 Tr. at 9 ("[The] fundamental problem as we [EPL] point out in great detail in our reply brief, is that Stone offers with the left hand and simultaneously takes back with the right hand."). ATS similarly maintains that Stone is using the threat of suit and Stone's "vague and undefined" interpretation of 6.2(e), "to shut the door on the EPL board's ability to take action in response to the ATS Tender Offer." ATS Opening Br. ("AOB") at 10-11.

[*35] The evidence also demonstrates that the controversy is substantial. As both EPL and ATS argue, the threat of a suit for actual damages for breach of a merger agreement that involves consideration on the order of a billion dollars can provide a powerful club to a party seeking to discourage competing transactions. According to ATS, Stone's actions raise the specter of a case like *Texaco v. Pennzoil.* [84] Moreover, Stone has argued that it would not be limited to its termination fee if EPL violated Section 6.2(e). [85]

84 *Texaco, Inc. v. Pennzoil Co., 729 S.W.2d 768 (Tex. App. 1987)* (awarding $ 8.53 billion in damages against Texaco that was found to have induced the Getty interests to breach their existing acquisition agreement with Pennzoil) *cited* in *Yanow v. Sci. Leasing, Inc.,* 1991 Del. Ch. LEXIS 134, 1991 WL 165304, at *10 (Del. Ch. July 31, 1991).

85 *See* Sept. 22 Tr. at 60-63 (discussing whether a claim for breach for conduct occurring prior to the time they [EPL] changed their recommendation. Stone's counsel maintains that given the circumstances, the action "... would be a breach, and because it occurred prior to the termination, we would still have a claim to pursue that breach." *Id.* at 62-63. The Court understands from Stone's arguments that it does not believe it would be limited to the termination fee for a violation of Section 6.2(e), but rather could elect to seek its actual damages.

[*36] Furthermore, because the ATS Tender Offer remains pending with a fairly imminent closing date, the controversy over the meaning and validity of Section 6.2(e) has sufficient immediacy and reality to warrant consideration of declaratory relief. [86] In fact, I conclude that the issues presented and the provisions of the Stone Merger Agreement relevant to resolving them support the existence of an actual controversy ripe for judicial determination as to EPL's ability to respond to *any* Third Party Acquisition Proposal, as defined in Section 10.1(i) of the agreement. By definition, all such proposals, like the ATS Tender Offer, must be "conditioned upon termination of th[e Stone Merger] Agreement and the abandonment of the Merger." [87] Thus, under a literal reading of Section 6.2(e) numerous actions that might be taken as to exploring or negotiating about the ATS Tender Offer might "reasonably be expected to impair the ability" of Stone and EPL to "consummate the Merger."

86 *See Step-Saver Data Sys., Inc. v. Wyse Tech., 912 F.2d 643, 647 (3d Cir. 1990).*

87 SMA at 50. Section 10.1(i) authorizes Stone to terminate the agreement if EPL's board "withdraws, modifies or changes its recommendation" of the agreement on the merger in a manner adverse to Stone in reference to a Third Party Acquisition Proposal. The Stone Merger Agreement further provides that if Stone terminates the agreement "under Section 10.1(i) (change of recommendation)" EPL shall promptly pay Stone the $ 26.5 million termination fee and that "[n]otwithstanding anything to the contrary contained herein," receipt by Stone of the termination fee "shall constitute full settlement of any and all

liabilities of [EPL] for damages under this Agreement in respect of a termination of this Agreement." SMA § 10.2(g),(i).

[*37] Lastly, I find unpersuasive Stone's argument that the dispute over the effect of 6.2(e) on the EPL Board's ability to communicate with ATS is moot because the Board already has recommended against the ATS Tender Offer. By exploring the ATS proposal further, EPL might acquire, for example, information relevant to its assessment of the Stone Merger. Moreover, the fact that EPL has recommended against the ATS Tender Offer does not preclude the possibility of future changes in the terms of that offer or EPL's evaluation of it. At argument, Stone's counsel acknowledged EPL's right under the Stone Merger Agreement to change its recommendation on the Stone Merger in reference to the ATS Tender Offer. [88] The current dispute over the effect of 6.2(e) threatens to chill the EPL Board's willingness to explore the Tender Offer directly with ATS. Thus, the dispute is not moot.

88 Sept. 22 Tr. at 57-59 (Stone's counsel responding to the Court's request to elaborate on the final recommendation of the EPL board, stated: ("[The EPL] board has a right under the contract to change its recommendation [with respect to the EPL - Stone [M]erger]." *Id.* at 57. *See also id.* at 59 (Jameson responding in the affirmative to the Court's clarification: "But we are clear that they [EPL] have the right to change their recommendation or to recommend against the EPL-Stone [M]erger, and that wouldn't be any violation of their rights in and of itself").

[*38] 2. Is there a justiciable dispute as to whether Section 6.2(e) restricts EPL's ability to pursue other Strategic Alternative Activities?

EPL also seeks a blanket declaration that Section 6.2(e) does not restrict EPL's ability to engage in each and all Strategic Alternative Activities, both in response to a third-party offer and of its own initiative. EPL asserts that Stone's preliminary proxy statement filed with the SEC on or about July 21, 2006 acknowledges EPL's ability to engage in Strategic Alternative Activities. [89] That document stated that in a June 7, 2006 meeting, representatives of Stone and EPL agreed, subject to resolution of other issues, that EPL "would not have any restriction on its ability to explore other possible acquisitions or combinations." EPL also asserts that a plain reading of the 6.2(e) language and a contextual understanding of 6.2(e) in relation to other sections within the Stone Merger Agreement support this interpretation. [90] Moreover, even if the language is ambiguous, EPL contends that the extrinsic evidence supports its right to pursue Strategic Alternative Activities. [91]

89 JX 12 at 65; EOB at 17.

[*39]

90 JX 1 at A43; EOB at 19, 20-24.

91 EOB at 27, 38.

In addition, ATS and EPL both argue that Section 6.2(e) is *per se* invalid under *Omnicare, QVC,* and *Quickturn.* [92] They further argue that under this Court's opinion in *Ace v. Capital Re,* Section 6.2(e) is invalid because "the board must be free to explore... a [third party] proposal in good faith." [93] Both ATS and EPL seek to have 6.2(e) declared null and void in its entirety. At argument, ATS argued alternatively that it would be sufficient for the Court to invalidate 6.2(e) only with respect to its tender offer. [94]

92 ATS's Opening Brief ("AOB") at 1, 5-10; EOB at 29; *Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003)*; *Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994)*; *Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998).*

93 *Ace, Ltd. v. Capital Re Corp., 747 A.2d 95, 107 (Del. Ch. 1999).*

[*40]

94 Sept. 22 Tr. at 117-18.

Stone replies by emphasizing that Section 6.2(e) is not written as a "no talk" or "no-shop" provision and does not operate as such because, in the context of the Stone Merger Agreement, it applies to EPL as the buyer and "addresses only conduct that would materially impair or delay the Merger." [95] Therefore, Stone argues, Section 6.2(e) is not a defensive response implicating policy concerns traditionally present in "no talk" or "no shop" provisions. Rather, Stone suggests that 6.2(e) "essentially articulates EPL's otherwise implied obligations of good faith and fair dealing," such that EPL will perform their end of the bargain. [96]

95 SAB at 28.

96 *Id.* at 28-29.

Stone further asserts that EPL seeks unreasonably broad declaratory relief. Stone argues that EPL has not identified any contemplated conduct or specific Strategic Alternative Activities that would provide [*41] a basis to test Section 6.2(e). [97] Stone cites to *Cantor Fitzgerald L.P. v. Cantor,* in which former Vice Chancellor, now Chief Justice Steele declined to rule on whether particular amendments to a partnership agreement were invalid on their face because the provisions lacked the context of any specific action or particularized allegations. [98] According to Stone, EPL's demand for declaratory judg-

ment with respect to the broad category of Strategic Alternative Activities fits squarely within *Cantor* as an amorphous abstraction.

97 EOB at 37.

98 *2001 Del. Ch. LEXIS 137, 2001 WL 1456494, at *6-7 (Del. Ch. Nov. 5, 2001).*

In *Cantor,* the Court declined to address whether certain amendments to a partnership agreement were invalid based on a related settlement agreement on tbe ground that the dispute was not ripe. In that regard, the Court stated:

> Only after the amendments are applied in specific factual settings may the Court judge them, and, as there is no current effort to apply the provisions **[*42]** to the defendants, consideration of the issue is premature.

And later concluded:

> In this action, the defendants have directed the Court's attention to several ways in which the amendments might arguably violate the Settlement Agreement. I have withheld ruling on these arguments because the precise facts of the individual situations where it might be alleged in the future that a party may have violated this order will be determinative and the speculative contentions are not now ripe." [99]

A similar situation exists as to EPL's request for declaratory relief applicable to Strategic Alternative Activities beyond exploration of the ATS Tender Offer and Third Party Acquisition Proposals.

99

*Cantor Fitzgerald, L.P. v. Cantor, 2001 Del. Ch. LEXIS 137, at *8, 10.*

From a discretionary standpoint, entertaining this broad set of circumstances also runs the risk of creating bad law. Delaware courts should be especially cautious when the request for relief in a declaratory judgment **[*43]** raises "novel and important [issues] to Delaware Corporate law." [100] Based on the nature of Plaintiffs' claims and the absence of a specific factual setting, I consider the *per se* challenge to the validity of Section 6.2(e) in relation to the broad category of Strategic Alternative Activities unsuitable for declaratory relief. Plaintiffs seek a declaration that one section of a lengthy merger agreement is invalid in its entirety or has no application whatsoever to a broad and loosely defined set of activities that EPL *might* elect to engage in, because otherwise the section might impermissibly circumscribe the ability of EPL's directors to perform their fiduciary duties.

100 *Bebchuk v. C.A., Inc., 902 A.2d at 740* (citing *Stroud, 552 A.2d at 480-81*).

Regarding the importance of the issues presented, Stone argues that provisions like Section 6.2(e) are common in merger agreements and that invalidating this provision therefore would effect numerous other merger agreements. **[*44]** In an addendum to its answering brief, Stone cites 19 merger agreements with provisions similar to 6.2(e). [101] The Court examined the text of a dozen of the publicly available merger agreements cited by Stone. Notably, unlike the situation presented by the Stone Merger Agreement, none of those merger agreements required the parent's stockholders to vote on the merger. [102]

101 The present situation is distinguishable from the merger agreements cited in Defendant's Addendum where no parent stockholder vote is required in that the EPL board can still change its recommendation as to the Stone-EPL merger and, although there is a force-the-vote provision, stockholders can still vote down the merger agreement. In this sense, the vote of the EPL stockholders is not guaranteed as it was in *Omnicare;* thus, the consummation of the Stone-EPL merger is not a *fait accompli. 818 A.2d at 939.*

102 Where no parent stockholder vote was required, the provisions similar to 6.2(e) conceivably could be construed as a type of "lock-up" guaranteeing deal certainty for the target and prohibiting the parent from engaging in *any* activity, strategic alternative or not, that would materially delay or impair the transaction. For example, one of the cited agreements provided:

> Parent: (ix) shall not, and shall not permit any of its Subsidiaries or affiliates to, take or agree to take any action (*including entering into agreements with respect to any acquisitions, mergers, consolidation or business combinations*) which would reasonably be expected to prevent, materially delay or materially impair the ability of Parent to consummate the Merger and the other transactions contemplated by this Agreement. (Emphasis added).

SAB Addendum at A. 5. In contrast, where a provision like 6.2(e) appears in a transaction requiring the Parent's stockholders' vote, there is either a fiduciary out, in a no-shop provision or elsewhere, or more commonly, provisions like 6.2(e) are limited to actions in the "ordinary course of business," implicitly excluding strategic transactions. *See generally id.* at B. Thus, the specific context of Section 6.2(e) in the Stone Merger Agreement may be unusual.

[*45] In such an important area of the law, this Court must carefully evaluate policy implications and legal determinations, which can only be sufficiently explored in relation to a discrete set of facts. Adjudication of Plaintiffs' claims in such a sparse factual setting also runs the risk of wasting resources of both the Court and the parties. This Court is reluctant to suggest or encourage preenforcement review of each and every action of a director in the context of competing acquisition proposals. [103] Lacking concrete and substantial facts and recognizing the importance and complexity of the issues presented, I do not find sufficient immediacy and justification in the present circumstances to warrant the exercise of my discretion under *10 Del. C. § 6506* to consider the issuance of a declaratory judgment as it pertains to Strategic Alternative Transactions.

103 *See, e.g., Ubiquitel Inc. v. Sprint Corp., 2006 Del. Ch. LEXIS 2, at *14-15 (Del. Ch. Jan. 4, 2006)* (emphasizing that "this Court does not have the time, the resources, or the inclination to attempt to resolve all uncertainties that might exist with respect to contractual rights and obligations, especially where, as here, both sides are capable of evaluating the comparative risks of each position and acting accordingly.")

[*46] Plaintiffs' claims for relief as to activities other than responding to the ATS Tender Offer and other Third Party Acquisition Proposals are also premature under the rubric that, "[i]f future events may obviate the need for declaratory relief, then the dispute is not ripe." [104] Furthermore, the court should consider whether the case is not "fit" for review based on "uncertain and contingent events that may not occur as anticipated, or may not occur at all." [105] Here, based on the possibility that EPL will go forward with the Stone Merger, the uncertainty as to whether the discussions with ATS now permitted under this Court's declaratory judgment will bear fruit, and numerous other contingencies, the Court need not address EPL's claims with regard to other Strategic Alternative Activities or ATS's *per se* invalidity challenge.

104 *Wal-Mart Stores, Inc., 872 A.2d at 631-32.*
105 *Bebchuk, 902 A.2d at 740* (citations omitted).

Simply put, there is no "present **[*47]** harm" to EPL as a result of the speculative "future consequences" of pursuit of some third party proposal that falls outside the scope of that defined in Section 10.1(i) and this Court's declaratory judgment. [106] There are inadequate facts and the chance is too remote and speculative that a future event will occur that would precipitate a breach of contract claim by Stone for open-ended damages based on Section 6.2(e). As such, the Court concludes that the Strategic Alternative Activities portion of this declaratory judgment action is not justiciable because it is not ripe.

106 *Florio, 40 F.3d at 1463* (quoting *Bell Atlantic Corp., 901 F. Supp. at 843*).

In its October 2 letter requesting reargument on the Court's September 27 oral ruling, EPL seeks "confirm[ation] that... EPL is permitted to 'solicit' potential third party acquisition proposals other than the ATS proposal." [107] In response, Stone argues that the Court's ruling held that the issue of "solicitation" of **[*48]** such proposals was unripe, and should not be revisited. [108]

107 Letter from Kevin Abrams, on behalf of EPL, to the Court (Oct. 2, 2006).
108 Letter from Bruce Jameson, on behalf of Stone, to the Court (Oct. 4, 2006).

Based on the standards of justiciability set forth above, the issue of whether EPL may engage in "solicitation" of acquisition proposals other than the ATS Tender Offer is premature. Under *Step-Saver* and *Ackerman,* EPL must allege facts that show a situation in existence and of sufficient immediacy that creates inevitable litigation to warrant a declaratory judgment. [109]

109 *Step-Saver Data Sys., Inc. v. Wyse Tech., 912 F.2d 643, 647 (3d Cir. 1990)*; *Ackerman v. Stemerman, 41 Del. Ch. 585, 201 A.2d 173, 175 (Del. 1964). See also Anonymous v. State, 2000 Del. Ch. LEXIS 84, 2000 WL 739252, at *4 (Del. Ch. June 1, 2000)* (identifying the burden of persuasion as that of the plaintiff).

[*49] In these cases regarding the Stone Merger and in its October 2 letter, EPL asserts that its Board wishes to "solicit" potential alternative transactions. EPL does not allege, however, any facts relating to actions by Stone that create an immediate controversy over any solicitations by EPL. To the contrary, Stone has stated: "[I]f EPL chooses to solicit, discuss and/or negotiate

other transactions, it can do so consistent with § 6.2(e) so long as EPL's parallel track towards consummation of the EPL-Stone Merger is unaffected." [110] Furthermore, EPL's October 2 letter makes clear that it believes it can solicit potential acquisition proposals without necessarily impairing its ability to complete the Stone Merger or materially delaying its closing. [111] EPL has not identified specific acts it intends to take by means of solicitation or alleged facts that suggest it faces an imminent threat of being sued. Whether and when such activity might occur that would create an alleged breach of contract is a highly factual inquiry and a matter of mere speculation at this time.

110 SAB at 16.

111 Mr. Abrams Oct. 2, 2006 letter at 4.

[*50] Based on these facts and the considerations mentioned in support of the September 27 oral ruling and this opinion, I am convinced that there is no actual and substantial controversy in terms of EPL's possible solicitation activities of "sufficient immediacy and reality to warrant the issuance of a declaratory judgment." [112] Thus, I deny EPL's request for reargument as to "solicitations." The facts indicate that EPL may engage in solicitation of other acquisition proposals at this time without being exposed to the threat of immediate or inevitable litigation; thus, there currently is no controversy on that issue ripe for judicial consideration.

112 *Step-Saver Data Sys., Inc., 912 F.2d at 647.*

III. Interpretation of the Stone Merger Agreement

A. Contract Construction Principles

The proper construction of a contract is purely a question of law. [113] Delaware courts interpret contracts from the perspective of an objective and reasonable third party. [114] The contract must also **[*51]** be read as a whole, so that the assessment of one section is consistent with the remainder of the contract. [115] Thus, a court must interpret contractual provisions in a manner that would give effect to every term of the instrument and reconcile all provisions of the instrument when read as a whole. [116]

113 *Lions Gate Entm't Corp. v. Image Entm't, Inc., 2006 Del. Ch. LEXIS 108, at *13 (Del. Ch. June 5, 2006); Pellaton v. Bank of New York, 592 A.2d 473, 478 (Del. 1991); Reardon v. Exch. Furniture Store, Inc., 37 Del. 332, 7 W.W. Harr. 332, 188 A. 704, 707 (Del. 1936).*

114 *NBC Universal, Inc. v. Paxson Commc'ns Corp., 2005 Del. Ch. LEXIS 56, at *13-14 (Del. Ch. Apr. 29, 2005)* (using the "objective" theory of contracts).

115 *Mehiel v. Solo Cup Co., 2005 Del. Ch. LEXIS 66, at *20 (Del. Ch. May 13, 2005). See Pharm-Eco Lab., Inc., v. Immtech Int'l, Inc., 2001 Del. Ch. LEXIS 21, 2001 WL 220698, at *7 (Del. Ch. Feb. 26, 2001)* ("The court should construe the contract 'as a whole, considering each clause and word with reference to all other provisions and giving effect to each wherever possible.'") (citation omitted).

[*52]

116 *Cove on Herring Creek Homeowners' Ass'n v. Riggs, 2003 Del. Ch. LEXIS 36, at *14-15 (Del. Ch. Apr. 9, 2003)*

A court must first determine whether a contract is ambiguous, or reasonably subject to more than one meaning. [117] Contractual terms will control if they establish both parties' common meaning where "a reasonable person in the position of either party would have no expectations inconsistent with the contract language." [118] A contract is not ambiguous in a legal sense merely because the parties in litigation differ on its meaning or construction. [119] Rather, contract ambiguity exists only when the controverted provisions are fairly susceptible of different interpretations or have two or more different meanings. [120]

117 *Cantera v. Marriott Senior Living Servs., Inc., 1999 Del. Ch. LEXIS 26, at *4 (Del. Ch. Feb. 18, 1999).*

118 *Eagle Indus., Inc. v. DeVilbiss Health Care, Inc., 702 A.2d 1228, 1232 (Del. 1997).*

119 *City Investing Co. Liquidating Trust v. Cont'l Cas. Co., 624 A.2d 1191, 1198 (Del. 1993); NBC Universal, Inc., 2005 Del. Ch. LEXIS 56, at *13-14.*

[*53]

120 *Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co., 616 A.2d 1192, 1196 (Del. 1992).*

If a contract is unambiguous, evidence beyond the language of the contract may not be used to interpret the intent of the parties or to create an ambiguity. [121] This is certainly the case where sophisticated corporations are involved. [122] As this Court repeatedly has noted, parties who elect to join together to pursue an enterprise have substantial knowledge of business operational frameworks, allowing for both parties "to make a thoughtful election with full knowledge of the significance of the operational framework they choose." [123] Accordingly, if a court finds that disputed contract language is unambiguous, then the court should rely solely on the clear, literal meaning of the words of the contract. [124] If ambiguity

exists, the court may use extrinsic evidence to assess the parties' intentions. [125] In determining the weight of parol evidence, a court may consider overt statements or acts of the parties, the business context, prior dealings between the parties, business [*54] customs or usage in the industry. [126]

121 *Pellaton v. Bank of New York, 592 A.2d at 478.*

122 *See Progressive Int'l Corp. v. E.I. du Pont de Nemours & Co., 2002 Del. Ch. LEXIS 91, 2002 WL 1558382, at *1 (Del. Ch. July 9, 2002)* ("Sophisticated parties are bound by the unambiguous language of the contracts they sign.").

123 *Cantor Fitzgerald, L.P. v. Cantor, 2001 Del. Ch. LEXIS 137, at *16-17 (Del. Ch. 2001)* (quoting *In re Marriott Hotel Props. II L.P. Unitholders Litig.*, Del. Ch., C.A. No. 14961, Allen, C. (June 12, 1996)).

124 *Liquor Exch., Inc. v. Tsaganos, 2004 Del. Ch. LEXIS 166, at *5 (Del. Ch. Nov. 16, 2004).*

125 *Pellaton v. Bank of New York, 592 A.2d at 478.*

126 *Comrie v. Enterasys Networks, Inc., 837 A.2d 1, 13 (Del. Ch. 2003).*

B. The Plain Language of the Merger Agreement Permits EPL to Pursue "Third Party Acquisition Proposals"

As related to the ability [*55] of EPL to investigate "Third Party Acquisition Proposals" as defined in Section 10.1(i), the Court finds no ambiguity in the language of Section 6.2(e). When viewed in the context of the entire Stone Merger Agreement, I conclude that Section 6.2(e) does not prevent EPL from investigating, negotiating about, or pursuing the ATS Tender Offer or any other Third Party Acquisition Proposal.

Article VI of the Agreement is entitled, "Conduct of Business Pending the Merger." It contains two sections, 6.1 and 6.2. Section 6.1 obligates the Target, Stone, between signing and closing to operate its business "in the ordinary course consistent with past practice" and not to take certain actions without the written consent of Parent, EPL. Section 6.1 contains 21 subparagraphs describing the types of actions subject to it. Section 6.2 obligates the acquirer, EPL, not to take certain types of actions before the closing without the written consent of Stone. It includes 7 subparagraphs, including the controverted Section 6.2(e).

The preamble to Section 6.2 makes clear that the language of the entire contract must be taken into consideration when construing the subsections of 6.2. [127] Interpreting [*56] the contract as a whole, the Stone Merger Agreement acknowledges and accounts for situations where EPL may be subject to third party proposals, even proposals that are conditioned on the termination of the Stone Merger. [128] For example, under Section 10.1(h), either EPL or Stone can terminate the Stone Merger if the target, Stone, accepts a Target Superior Proposal. [129] The Stone Merger Agreement also reflects that, consistent with its fiduciary duties to its stockholders, EPL may change its recommendation of the Stone Merger. [130] This right is reflected in Section 7.13, for example. Section 7.13(b) requires EPL to hold a special meeting of its stockholders to secure their approval of the Stone Merger. The section explicitly states, however, that it does not prohibit EPL's Board from modifying its recommendation to its stockholders if the Board in consultation with independent legal counsel "determines in good faith that such action is necessary... to comply with its fiduciary duties."

127 Section 6.2 uses the phrase "[e]xcept as expressly permitted or required by this Agreement..." to preface the subsections. Accordingly, based on principles of contract construction as well as the explicit language of its preamble, Section 6.2(e) must be read in light of EPL's rights and obligations under the overall Stone Merger Agreement.

[*57]

128 *See* SMA § 10.1, accounting for and defining valid termination situations. "Third Party Acquisition Proposal" is defined for Section 10.1(i) as "an inquiry, offer or proposal" that is "conditioned upon the termination" of the merger agreement and "abandonment" of the merger and in which the third party would acquire "30% or more" of EPL. SMA at 50.

129 SMA § 10.1(h), defining a "Target Superior Proposal" as a bona fide written Target Acquisition Proposal not solicited by Target and made by a third party in accordance and without breaching § 7.2(a) (a no-shop provision applicable to Stone). Stone's acceptance of such a proposal would expose it to liability to pay the Target Termination Fee.

130 SMA §§ 7.13(b), 10.1(i).

In addition, Section 10.1(i) explicitly recognizes that EPL might withdraw or modify its recommendation in reference to a proposal conditioned upon the termination of the Stone Merger Agreement and abandonment of the Merger, *i.e.*, a Third Party Acquisition Proposal, such as the ATS Tender Offer. In the words of Section 6.2(e), one could [*58] argue that such a change of recommendation "would reasonably be expected to materially impair the ability of [the parties] to consummate the merger." The other provisions of the Stone Merger Agreement, however, indicate that Stone's remedy for

EPL changing its recommendation in reference to a Third Party Acquisition Proposal is to terminate the agreement and receive the EPL Termination Fee. [131]

131 *See* SMA §§ 10.1(i), 10.2(g), (i).

Taken together, these provisions are internally consistent with the plain reading of the Stone Merger Agreement. The provisions indicate that the parties contemplated that just such an event as the ATS Tender Offer might occur and that in reference to it, EPL's board, consistent with its fiduciary obligations, could investigate or pursue the Third Party Acquisition Proposal and potentially recommend against the Stone Merger. Under the plain language of the entire merger agreement, EPL is free to pursue Third Party Acquisition Proposals that qualify under the definition **[*59]** in 10.1(i). [132] Nothing in the Stone Merger Agreement suggests that Section 6.2(e), as part of the provisions governing conduct of the business of the acquirer pending the merger, should be read to be inconsistent with the plain language of Sections 7.13(b) and 10.1(i) and the recognition implicit in those sections that EPL would have the ability to explore Third Party Acquisition Proposals and negotiate about them, if it determines that to be advisable. [133]

132 *See Phillips Home Builders v. Travelers Ins. Co., 700 A.2d 127, 129 (Del. 1997)* ("When there is a written contract, the plain language of a contract will be given its plain meaning.").

133 *See Capano v. Capano, 2003 Del. Ch. LEXIS 125, 2003 WL 22843906, at *5 (Del. Ch. Nov. 14, 2003)* ("'Where there is an inconsistency between general provisions and specific provisions, the specific provisions ordinarily qualify the meaning of the general provision.' This is so because of the 'reasonable inference that specific provisions express more exactly what [the] parties intend than broad or general terms.'") (citations omitted).

[*60] The Stone Merger Agreement has an unusual combination of provisions, or rather absence of provisions, which arguably might cause Section 6.2(e) to function in a manner and a specific situation that its drafters may not have appreciated. That is, when Stone and EPL agreed that there would not be a "no-shop" provision applicable to EPL and removed Section 10.1(j) that would have given EPL the right to terminate the Stone Merger Agreement in response to a third party proposal, they may have created the possibility of an ambiguity in the application of Section 6.2(e) in the face of some third party transaction. The parties apparently dispute whether this was intentional to assure "deal certainty" for Stone, or inadvertent as EPL maintains. [134] The Court need not resolve any such dispute for purposes of its decision, based on the plain language of the Agreement, as to exploration of the ATS Tender Offer and Third Party Acquisition Proposals. For the reasons stated in Part II.C.2 *supra,* it is premature to consider any additional and potential factual situations that might fall under the broad umbrella of Strategic Alternative Activities.

134 *See* Sept. 22 Tr. at 63-64, a discussion of Stone's rejection of the proposed Section 10.1(j), which would have permitted EPL to terminate the agreement in the event they accepted a Third Party Acquisition Proposal, so that Stone could maintain "a certain amount of deal certainty." Stone refers to EPL correspondence that confirms their understanding of 10.1(j) as consistent with Stone's interpretation.

[*61] 1. Even if extrinsic evidence is considered, the Stone Merger Agreement Permits EPL to pursue "Third Party Acquisition Proposals"

Even if the Court were to find an ambiguity in Section 6.2(e) when read in the context of the Stone Merger Agreement as a whole, which it does not, an analysis of relevant extrinsic evidence would resolve that ambiguity against Stone. The undisputed evidence shows that the parties did not discuss Section 6.2(e) in their negotiations, and that it was a hold over from the Plains Merger Agreement. [135] Also, although Stone requested that EPL agree to a no-shop provision that would bind EPL on terms comparable to Stone's, EPL repeatedly and consistently rejected that request. [136] At a meeting of the parties' representatives on June 7, 2006, Stone agreed that EPL would not be bound by a no-shop; hence, the final agreement does not contain a no-shop restraining EPL. [137] Thus, construing Section 6.2(e) to preclude EPL from communicating or negotiating with ATS or the maker of any other Third Party Acquisition Proposal would be inconsistent with the extrinsic evidence and contrary to the parties' manifest intent.

135 Joint Pretrial Order at 3.

[*62]

136 *Id.*

137 *Id.*

2. Delaware law supports a construction of 6.2(e) that permits EPL to pursue "Third Party Acquisition Proposals"

The reasoning of *Ace v. Capital Re* supports the same result. In *Ace,* in the context of a request for injunctive relief *pendente lite,* the Court construed a disputed contractual provision that arguably impermissibly circumscribed the directors' unfettered ability to fulfill

their fiduciary duties. [138] The provision at issue in that case was a fiduciary out clause associated with a "no-talk" provision conditioned, "on the written advice of [the target's] outside legal counsel, that participating in such negotiations or discussions or furnishing such information is required in order to prevent the Board of Directors of the Company from breaching its fiduciary duties to its stockholders." [139] The dispute involved whether the "written advice" requirement had been satisfied. Vice Chancellor Strine reasoned that under one interpretation of *QVC* there would likely never be a case where the board was *required* to speak to **[*63]** a third party in a non-change of control transaction. [140] The Vice Chancellor added, however, that should such a situation occur, the provision might then be construed as "an abdication by the board of its duty to determine what its own fiduciary obligations require." [141] If so interpreted, such a contractual provision would be inconsistent with the director's fiduciary duties and, therefore, invalid. [142] To avoid this result, the Court held that the provision more likely would be construed consistently with the board's fiduciary duties.

138 *See Ace Ltd. v. Capital Re Corp., 747 A.2d 95, 103-04 (Del. Ch. 1999)* (holding that if Ace's interpretation is correct, it is "likely invalid"); *see also Restatement (Second) of Contracts § 193* (1981) (a "promise by a fiduciary to violate his fiduciary duty or a promise that tends to induce such a violation is unenforceable on public policy grounds.").

139 *Ace, 747 A.2d at 98.*

140 *Id. at 107* (finding that the *Ace* factual situation did not present such a scenario); *see also id. at 107-08* ("But QVC does not say that a board can, without exercising due care, enter into a non-change of control transaction affecting stockholder ownership rights and imbed in that agreement provisions guaranteeing that the transaction will occur and that therefore absolutely preclude stockholders from receiving another offer that even the board deems more favorable to them.").

[*64]

141 *Id. at 106-07.*

142 *Id. at 104.*

Similar reasoning applies here. In interpreting the ACE-Capital Re merger agreement, the Court recognized that the parties to the transaction were aware of the scope of the directors' fiduciary duties and, in effect, construed the provisions of the agreement consistent with those duties. [143] This conclusion comports with the record established in this case in terms of the EPL-Stone merger. For example, when asked whether EPL could recommend in favor of the ATS Tender Offer, Stone's counsel responded, "I do not believe that would be a breach of 6.2(e)." [144] Likewise, throughout Stone's briefs, it vigorously maintains that there is no *per se* ban on EPL's speaking to ATS or shopping the transaction. Implicit in these representations is a recognition that such a complete ban would likely be incompatible with the directors' fiduciary duties and, therefore, void. [145] The structure of the no-shop provision applicable to Stone and the clauses in the nature of fiduciary outs in the Stone Merger Agreement demonstrate **[*65]** that Stone and EPL recognized this reality. Accordingly, the Court construes the Stone Merger Agreement, in general, and Section 6.2(e), in particular, as being consistent with that understanding and permitting EPL to explore Third Party Acquisition Proposals, as long as it does so in good faith.

143

Id. at 109 ("As a sophisticated party,... ACE was on notice of its possible invalidity. This factor therefore cuts against its claim that its contract rights should take precedence over the interests of the Capital Re stockholders who could be harmed by enforcement of § 6.3.) (citing *QVC, 637 A.2d at 51*; Paul L. Regan, Great Expectations? A Contract Law Analysis For Preclusive Corporate Lock-Ups, *21 CARDOZO LAW REV. 1, 76-81 (1999)*).

144 Sept. 22 Tr. at 82. Whether, consistent with Section 6.2(e), EPL could change its recommendation against the ATS Tender Offer to one in favor of it based on its communications with ATS is an interesting, hypothetical extension of the Court's ruling that EPL has the right under the Stone Merger Agreement to explore Third Party Acquisition Proposals, like the ATS Tender Offer. That issue is not ripe, however, for several reasons. First, EPL publicly has recommended against the ATS Tender Offer based on three different opinions from investment bankers that the price was too low. There is no basis beyond mere speculation to believe that EPL would change that recommendation. Second, Stone's counsel's statement that he did not believe a change of recommendation as to the ATS Tender Offer would breach 6.2(e) suggests that Stone might not claim a breach or might consent to EPL's changing its recommendation. That possibility is made more likely by the legal constraints on contractual attempts to circumscribe the ability of directors to fulfill their fiduciary duties. In short, future events may well obviate or moot this issue; thus, it is not ripe for judicial consideration at this time.

[*66]

145 *Cf. Ace, 747 A.2d at 107* (discussing a superior proposal and noting that "the board must be free to explore such a proposal in good faith").

C. Plaintiffs' *Per Se* Invalidity Claims as to Exploration of Third Party Acquisition Proposals, such as the ATS Tender Offer

With regard to Plaintiffs' *per se* invalidity claims as to the application of Section 6.2(e) to the ATS Tender Offer or other Third Party Acquisition Proposals, the Court's construction of the Stone Merger Agreement and 6.2(e) as permitting exploration of such proposals eliminates the predicate for those claims. Accordingly, the Court need not address them further.

IV. CONCLUSION

For the reasons stated, I hold that EPL and ATS are entitled to a declaratory judgment that Section 6.2(e) of the Stone Merger Agreement does not limit the ability of EPL to explore in good faith any Third Party Acquisition Proposals, including the ATS Tender Offer. I hereby dismiss without prejudice all of the other aspects of EPL's claims in C.A. No. 2402-N as not ripe and failing to provide a sufficient actual [*67] controversy to enable or persuade the Court to exercise jurisdiction over those claims under *10 Del. C. §§ 6501-13*. Regarding the *per se* invalidity claim as to Section 6.2(e) in the ATS complaint, C.A. No. 2347-N, I deny the requested relief as it relates to EPL's consideration of any Third Party Acquisition Proposals, including the ATS Tender Offer, as moot based on my construction of 6.2(e); in all other respects ATS's *per se* invalidity claim as to Section 6.2(e) is dismissed without prejudice as not ripe for the same reasons as the comparable portions of the EPL claims.

IT IS SO ORDERED.

TAB 4

LEXSEE 1992 DEL CH LEXIS 317

FOOD AND ALLIED SERVICE TRADES, AFL-CIO, Plaintiff, v. WAL-MART STORES, INC., Defendant.

C.A. No. 12551

COURT OF CHANCERY OF DELAWARE, NEW CASTLE

1992 Del. Ch. LEXIS 317

May 5, 1992, Decided
May 5, 1992, Filed

COUNSEL: [*1] Allen M. Terrell, Jr., Gregory P. Williams, Richards, Layton & Finger, One Rodney Square, P. O. Box 551, Wilmington, Delaware 19899, Attorneys for Plaintiff Food and Allied Service Trades.

OPINION

COMPLAINT

Plaintiff Food and Allied Service Trades, AFL-CIO ("FAST"), by its undersigned attorneys, for its complaint herein, alleges as follows:

NATURE OF THE ACTION

1. Plaintiff, the beneficial and record owner of twenty-three (23) shares of common stock of Wal-Mart Stores, Inc. ("Wal-Mart" or the "Company"), brings this action pursuant to section 220 of the General Corporation Law of the State of Delaware for an order to compel defendant Wal-Mart to produce for inspection and copying the Company's stockholder list and related materials (the "List").

2. On April 24, 1991, FAST sent to Wal-Mart a facsimile version of a written demand (the "Demand"), under oath, to inspect and copy the List for a proper purpose reasonably related to FAST's interest as a stockholder. On April 27, 1992, the original Demand was delivered to Wal-Mart at its principal place of business. A copy of the Demand, with accompanying affidavit, is appended hereto as Exhibit A.

3. Wal-Mart has not agreed to allow FAST [*2] to inspect and copy the list and five business days have elapsed since the Demand was made. Accordingly, pursuant to section 220 of the General Corporation Law of the State of Delaware, FAST is entitled to inspect the List.

PARTIES

4. FAST is and has been at all relevant times an unincorporated labor organization that is a constitutional department of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO). At all relevant times, FAST was the record and beneficial owner of twenty-three (23) shares of Wal-Mart common stock.

5. Wal-Mart is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Bentonville, Arkansas.

JURISDICTION

6. The Court has exclusive jurisdiction over this action pursuant to section 220(b) of the General Corporation Law of the State of Delaware.

FAST DEMANDS THE WAL-MART LIST FOR A PROPER PURPOSE AND IS THUS ENTITLED TO INSPECT AND COPY IT UNDER SECTION 220

7. As stated in the Demand, the purpose of FAST's demand to inspect and copy the stockholder list is:

> to permit the undersigned [FAST] to communicate with other stockholders of the Company on matters relating [*3] to their interest as stockholders, including communicating with such stockholders regarding a solicitation of proxies to be conducted by the undersigned in connection with the Company's 1992 Annual

> Meeting of Shareholders, scheduled for June 5, 1992, in support of an independent shareholders' resolution recommending that the Board of Directors establish a Special Committee to study and report to the Board of Directors and to the shareholders on the Company's buying policies and practices in China, with special attention to ensuring that no products purchased directly and/or indirectly from sources in China are produced wholly or in part by forced labor. The purpose of this demand for a stocklist is also to permit the undersigned to furnish the Company's stockholders with copies of proxy materials relating to that resolution and to solicit proxies from those stockholders.

8. FAST thus demands the List for a proper purpose reasonably related to FAST's interest as a stockholder. Accordingly, FAST is entitled to inspect and copy the List pursuant to section 220 of Delaware's General Corporation Law.

9. FAST has no adequate remedy at law.

WHEREFORE, FAST respectfully requests this Court **[*4]** to issue an order:

A. declaring FAST to be entitled to the inspection it demands from Wal-Mart;

B. directing Wal-Mart to produce forthwith, for inspection and copying by FAST, and by its agents and attorneys as appointed in the Demand, the List, including:

> (1) a complete record or list of stockholders of the Company, certified by its transfer agent, showing the name and address of each stockholder and the number of shares of stock registered in the name of each stockholder as of the most recent date available;
>
> (2) a magnetic computer tape list of the stockholders of the Company as of the most recent date available, showing the name and address of, and the number of shares held by, each stockholder, and such computer processing data as is necessary to make use of such magnetic computer tape;
>
> (3) all transfer sheets showing the changes in the list of stockholders of the Company subsequent to the date of the most recent stockholder list referred to above that are in the possession or control of the Company or its transfer agent from the date of the list to the conclusion of the solicitation referred to above;
>
> (4) all information that is in or comes into the Company's possession or **[*5]** control, pursuant to Rule 14b-1(b) promulgated under the Securities Exchange Act of 1934 or otherwise, concerning the names and addresses of, and the number of shares of the Company's common stock held by, the beneficial owners of the Company's common stock whose shares are held of record by brokers, dealers, banks, clearing agencies, voting trustees or any other entity that exercises fiduciary powers in nominee name or otherwise, including nominees of any central certificate depository system. Such information includes but is not limited to (a) all breakdowns of any holdings in the nominee names of Cede & Co., Kray & Co., Philadep, and/or other similar securities depositories or nominees, and (b) all lists and printouts of non-objecting beneficial owners from Independent Election Corporation of America and from ADP-Proxy Services;
>
> (5) all information that is in or comes into the Company's possession or control, or that can be reasonably obtained from voting trustees or others, concerning the names and addresses of, and the number of shares of the Company's common stock held by, the beneficial owners of the Company's common stock pursuant to any employee stock plan, along with the **[*6]** material request form from The Independent Election Corporation of America;
>
> (6) all modifications, additions or deletions to any and all information referred to in paragraphs 1 through 5 above as such modifications, additions or deletions become available to the Company or to its agents or representatives from the most recent date available as of the date of the Demand to the date of the solicitation referred to above.

C. directing Wal-Mart to update such production from time to time, as requested in FAST's written demand under oath; and

D. granting plaintiff FAST such other and further relief as the Court deems just and proper.

Dated: May 5, 1992

TAB 5

LEXSEE 1997 DEL. CH. LEXIS 59

INTERNATIONAL EQUITY CAPITAL GROWTH FUND, L.P., Plaintiff, v. C. STEPHEN CLEGG and JACOB POLLOCK, Defendants, and GLOBE BUILDING MATERIALS, INC. and DIAMOND HOME SERVICES, INC., Nominal Defendants

Civil Action No. 14995

COURT OF CHANCERY OF DELAWARE, NEW CASTLE

1997 Del. Ch. LEXIS 59

August 16, 1996, Date Submitted
April 21, 1997, Date Decided

SUBSEQUENT HISTORY: [*1] Released for Publication by the Court May 12, 1997.

DISPOSITION: Plaintiff's claims arising out of Diamond's efforts to purchase Handy Craftsman and Globe's efforts to sell portion of interest in Diamond dismissed without prejudice. Remainder of plaintiff's claims, individual defendants' motion to dismiss DENIED.

COUNSEL: Martin P. Tully, Esquire and S. Mark Hurd, Esquire, of MORRIS, NICHOLS, ARSHT & TUNNELL, Wilmington, Delaware, Attorneys for Plaintiff.

Charles S. Crompton, Jr., Esquire and Arthur L. Dent, Esquire, of POTTER, ANDERSON & CORROON, Wilmington, Delaware, Attorneys for Defendants C. Stephen Clegg and Jacob Pollock.

Lawrence S. Drexler, Esquire, of OBERLY, JENNINGS & DREXLER, P.A., Wilmington, Delaware, Attorneys for Nominal Defendants, Globe Building Materials, Inc., and Diamond Home Services, Inc.

JUDGES: ALLEN, Chancellor

OPINION BY: ALLEN

OPINION

MEMORANDUM OPINION

ALLEN, Chancellor

In this action a 26% shareholder in a close corporation challenges a series of transactions between the corporation, its 80% owned subsidiary Diamond Home Services, ("Diamond"), and two directors of both corporations. The action is before this court on a motion to dismiss the complaint pursuant [*2] to Court of Chancery Rule 23.1, and with regard to certain claims, for dismissal for lack of standing and failure to state a claim on which relief can be granted. The motion has been brought by the individual defendants. This motion requires determining the independence of a board of directors for the purposes of excusing demand under Rule 23.1; the time of an alleged wrong in a continuing contractual relationship, for the purposes of determining a shareholder's standing to challenge that alleged wrong; and the ripeness for adjudication of an alleged usurpation of a corporate opportunity and an uncompleted merger transaction.

This action is brought as a derivative claim by International Equity Capital Growth Fund, L.P. ("Fund"), purportedly on behalf of Globe Building Materials, Inc. ("Globe"). The complaint alleges that C. Stephen Clegg ("Clegg") and Jacob Pollock ("Pollack"), the chairman and CEO and a director, respectively of both Globe and its subsidiary, have engaged in transactions with Globe and Diamond to the detriment of those companies in violation of their fiduciary duties. Plaintiff seeks (1) a declaration the defendants violated their fiduciary duties (2) recissory and [*3] compensatory damages and (3) a declaration that the announced terms of Diamond's proposed acquisition of The Handy Craftsman, Inc. ("Handy Craftsman") are unfair to Diamond.

For the reasons set forth below, I conclude that (1) plaintiffs have met their burden under Court of Chancery Rule 23.1 of casting reasonable doubt upon the independence of the Globe and Diamond boards with respect to the majority of the transactions that are the basis for this action; (2) the plaintiffs have alleged specific facts relating to the performance of the financial services contract that state a claim which the plaintiffs have standing to assert; and (3) while the alleged usurpation of a corporate opportunity has been completed, the agreement between Diamond and Handy Craftsman as described in the plaintiffs pleadings does not constitute a claim ripe for judicial review. Consequently, the defendant's motion for dismissal pursuant to Rule 23.1 for failure to make demand and for lack of standing must in large part be denied, while the defendant's motion to dismiss claims relating to Diamond's prospective purchase of Handy Craftsman is granted and those claims will be dismissed without prejudice.

I. [*4] THEORIES OF THE COMPLAINT

Count 1 of the Complaint accuses Mr. Clegg of arranging for Globe to enter into transactions in which he had a personal financial interest and which were unfair to Globe. Count II accuses Mr. Clegg of arranging for Diamond to enter into unfair self-dealing transactions in violation of his fiduciary duty of loyalty. Count II accuses Mr. Pollock of arranging the sale of the Chester Facility to Globe in violation of his fiduciary duties of loyalty to Globe. Count IV accuses Mr. Clegg of usurping a corporate opportunity of Diamond's when he purchased Handy Craftsman in 1995.

With regard to Fund's standing to litigate issues relating to the 1989 Financial Services Agreement between Globe and Clegg Industries, Fund claims that Globe's payments under the Agreement became wasteful in 1993 when Clegg Industries became incapable of rendering any services in consideration for the payments. Consequently, Fund argues the wasteful conduct occurred in 1993, after it had made its investment in Globe. As to the ripeness of Fund's claim regarding Diamond's purchase of Handy Craftsman, Fund asserts that Diamond and Clegg have entered into an agreement in principle, a contractual [*5] obligation under Delaware law subject to judicial review.

II. THE PARTIES

Plaintiff is a Bermuda partnership, that on December 31, 1992, purchased 505 shares of Globe common stock, warrants to purchase 1,350 shares of Globe common stock, and $ 2,000,000 in Globe subordinated debt. Currently, Fund owns 630 shares of Globe common stock, comprising 26.2% of Globe's total common stock.

Nominal defendant Globe is a Delaware corporation manufacturing shingles and other roofing products. Globe was formed in 1989 by Clegg Industries. Nominal defendant Diamond is a Delaware corporation formed in 1993 by Globe. Diamond markets and sells residential roofing systems and home improvement products. It is 80% owned by Globe.

C. Stephen Clegg is the Chairman of the Board, Chief Executive Officer, Treasurer, and Assistant Secretary of Globe. He also controls the voting rights for 1,472 shares of Globe stock (56.3% of the voting stock). Directly or indirectly, Mr. Clegg owns or controls 888 shares; 240 of these shares are held by Globe Investors, Inc, 47% of whose voting shares are owned by Clegg, and 223 shares are held by 29 W Partners, 100% of whose voting shares are held by Clegg. Clegg [*6] is Chairman of the Board, Chief Executive Officer, and President of Diamond. In addition, Clegg is Chairman of the Board and Chief Executive Officer of Clegg Industries, Mid-West Spring Manufacturing Company, Catalog Holdings, Inc. ("CHI"), and a director and member of the Compensation Committee of the Board of Directors of Ravens Metal Products, Inc. ("Ravens").

Defendant Jacob Pollock has been a director of Globe since 1989, and a director of Diamond since September, 1993. He is also a director of Spring, and the controlling shareholder, Chairman of the Board and Chief Executive Officer of Ravens. Additionally, he allegedly owns and controls J. Pollock & Company.

The directors of Globe currently are Clegg, Pollock, Globe Vice-President John Klikus ("Klikus") and George A. Stinson ("Stinson"). The directors of Diamond are Clegg, Pollock, Diamond Vice-President James M. Gillespie ("Gillespie"), Stinson, and James F. Bere Jr.

III. GOVERNANCE OF GLOBE AND DIAMOND GENERALLY

Defendants' motion seeks to dismiss all claims for failure to make demand upon the boards of Globe and Diamond pursuant to Court of Chancery Rule 23.1. Plaintiff's argument that demand is excused rests in every [*7] case on the alleged lack of independence of the majority of those boards. The evaluation of the independence of a board for the purposes of a Rule 23.1 motion is necessarily factually specific. There are few bright lines. Evaluation of director independence for this purpose is performed under the cross-pressures of two applicable principles. First, at such an early stage, plaintiff should be accorded the benefit of a pleading doubt. Second, plaintiff must however not rely on "conclusions" but must plead specific "facts" showing a reasonable doubt as to the applicability of the business judgment presumption.

In evaluating whether the plaintiff has cast reasonable doubt on these Boards' ability independently to evaluate these transactions at the time this suit was filed, I place weight on several allegations that bear upon the extent of the independence of a majority of the boards of directors of Globe and Diamond from Clegg. First, Clegg held 56% of the voting stock of Globe at the time of the filing of the complaint. Globe held 80% of the voting stock of Diamond. Consequently, it was within Clegg's power to designate and to remove members of either Board if he felt so moved. Allegations **[*8]** of voting control coupled with self interested transactions themselves go very far to excusing demand. Second, Clegg is alleged to have used this power in his management of each Board between January and May of 1996 for the purposes of removing directors who had exercised independent judgement.

In January 1996, Mr. Clegg allegedly refused to reappoint the independent director Abplanalp to the Globe board, replacing him with Globe Vice President John Klikus. Also in January, Mr. Clegg allegedly fired Mr. Griffin as Chief Executive Officer of Diamond and had him removed from Diamond's board, following a disagreement over a transaction in which Mr. Clegg had a personal interest. Finally, Mr. Clegg is alleged to have threatened Mr. Lefkowitz, the plaintiff's nominee to the Globe Board of Director, with being removed from the Globe board at some unspecified time, and to have then actually purported to remove him after plaintiff filed this action.

As to the role of plaintiffs, I note that Fund made a substantial investment in Globe more than three years before the complaint was filed. It sought to participate in the Globe's governance by designating Lefkowitz to Globe's board under a Shareholders [*9] Agreement. Lefkowitz is alleged to have objected to some of the transactions which are the subjects of this action. I conclude that these allegations are sufficient to raise a reasonable doubt concerning the independence of the Globe and Diamond boards.

IV. THE CLEGG-GLOBE TRANSACTIONS

A. The Financial Services Transactions

Upon Clegg Industries' incorporation of Globe in 1989 and Mr. Clegg's appointment of Globe's directors, Globe entered into a contract with Clegg Industries for unspecified financial services pursuant to which Globe would pay Clegg Industries $ 350,000 per year (the "Financial Services Agreement"). In addition, under the contract, Globe was required to compensate any Clegg Industries employee while working for Globe without any reduction in the $ 350,000 payment due Clegg Industries under the Agreement. This contract was in force at the time of Fund's initial investment in Globe on December 31, 1992.

It is alleged that during 1993, all Clegg Industries employees other than Mr. Clegg were transferred from the Clegg Industries payroll to the Globe payroll. Among the employees purportedly so transferred was a particular Clegg Industries employee who had been **[*10]** performing financial services for Globe. Payments to Clegg Industries under the Financial Services Agreement continued.

Secondly, in July 1993, Globe issued Clegg Industries 1,534 shares of its preferred stock and warrants to purchase 13 shares of common stock having a total assigned value of $ 152,000. These securities were purportedly issued to compensate Clegg Industries for investment banking services related to Globe's 1993 investment in Diamond. In December 1993, Globe paid Clegg Industries a further $ 150,000, purportedly as compensation for work related to Globe's senior note offering earlier in 1993. Both payments were approved by Globe's Board of Directors and, plaintiff claims, governed services of the type Clegg Industries had an obligation to provide Globe under the 1989 Financial Services Agreement. Thus the payments are alleged to be wasteful and unfair self-dealing.

Thirdly, in January 1995, Mr. Clegg dismissed the Chief Executive Officer of Diamond and assumed the position himself at a salary of $ 100,000 per year. Pursuant to Globe's Bank Loan and Security Agreement, payments under the Financial Services Agreement had to be reduced to $ 250,000 per year as a result. **[*11]** The $ 100,000 payment to Clegg is challenged as a breach of loyalty.

1. Plaintiff's Standing to Challenge the Financial Services Transactions

For a plaintiff to have standing to bring a derivative action, that plaintiff must have been a shareholder of the corporation at the time the alleged wrong was committed, and must remain a shareholder through the course of the derivative action. *8 Del. C. § 327.* Plaintiff claims that Clegg Industries' failure after 1993 to provide services under the Financial Services Agreement created a right to terminate its payments which Globe failed to assert. A failure by a corporation to assert a legal right at the time that right comes into being may be a breach of duty, and thus a possible basis for a shareholder's derivative action. [1] Plaintiff was a shareholder throughout 1993 and has remained a shareholder since that time. Consequently plaintiff has standing to bring claims for breach of fiduciary duty arising out of Globe's failure to enforce its contract with Clegg Industries. [2]

1 *Mills Acquisition Co. v. MacMillan, Inc., Del. Supr., 559 A.2d 1261, 1280 (1989).*

[*12]

2 The standing rule is to be construed to facilitate the discovery of wrongdoing and discourage "strike suits." There is precedent suggesting that even were the transaction under consideration found to have commenced with the execution of the Financial Services Agreement in 1989, in the particulars of this case, where the plaintiff has a substantial and continuing equity investment, a limited equitable exception to the standing requirement to facilitate the correction of corporate wrongdoing may apply. *Schreiber v. Bryan, Del. Ch., 396 A.2d 512 (1978); MacIray v. Pleasant Hills, Inc., Del. Ch., 35 Del. Ch. 39, 109 A.2d 830 (1954).*

2. Demand Excused

Rule 23.1 requires plaintiffs in a derivative action to "allege with particularity" their reasons for not making a pre-suit demand upon the board of directors to bring the action. Its purpose is to "ensure that a stockholder exhausts his intra corporate remedies, and then to provide a safeguard against strike suits." *Aronson v. Lewis, Del. Supr., 473 A.2d 805, 811 (1984).* Plaintiff has the burden of alleging particularized facts raising **[*13]** a reasonable doubt that the board of directors is disinterested and independent or that challenged transactions were the product of a valid exercise of business judgment. *Aronson v. Lewis, supra.*

The complaint involves a number of separate transactions occurring over several years and involving different persons in different capacities. In these circumstances, the appropriate approach to board independence is to review each board's independence with respect to each transaction alleged to give rise to a claim against the defendant directors of that corporation.

For the reasons discussed below, I find plaintiff has met its burden of alleging specific facts raising reasonable doubts as to the majority of the board's independence when approving the Financial Services Transactions.

The Financial Services Transactions allegedly each involved Mr. Clegg or corporations he controlled as counter parties. Because Mr. Clegg is alleged to have voting control of Globe, this conflict of interest is sufficient to cast reasonable doubt on Mr. Clegg's independence. But there is more alleged than this alone. Mr. Klikus is an employee of Globe answering to Mr. Clegg. Mr. Clegg allegedly named him **[*14]** to the board in January 1996, replacing the long-standing independent board member, Abplanalp. Additionally, plaintiff alleges that in early 1996, Mr. Clegg removed John Griffin as President of Diamond for refusing to enter into an interested transaction with Mr. Clegg at the price Mr. Clegg desired. This allegation supports an inference that Mr. Klikus was aware of the alleged circumstances surrounding Mr. Griffin's dismissal. In light of Mr. Clegg's control of 56% of Globe's voting stock, these additional alleged facts are sufficient to support the inference that Klikus is beholden to Clegg and therefore to cast doubt on his ability to independently review the Financial Services Transactions.

With respect to the independence of Mr. Pollock, defendant rightly argues that Mr. Pollock does not have a direct interest in the Financial Services Transactions or the other Clegg-Globe Transactions. Pollock did approve each of the transactions named in this complaint in which either he or Clegg was the counter party. Pollock benefitted from certain of these transactions; Clegg benefitted from others, at the alleged expense of Globe. These allegations reflecting a clear pattern of mutual advantage **[*15]** is sufficient in my opinion to raise a reasonable doubt concerning Mr. Pollock's independence of Mr. Clegg. Finally, Mr. Clegg is on the Compensation Committee of Ravens, with direct involvement in setting Mr. Pollock's compensation as Chief Executive Officer of that company.

Perhaps neither Mr. Clegg's control of the majority of shares of Globe, Mr. Pollock's approval of any single one of the Clegg-Globe Transactions, Mr. Clegg's serving on Ravens' board of director, nor Mr. Pollock's appointment by Mr. Clegg, each taken in isolation, would be sufficient to cast reasonable doubt on Mr. Pollock's independence with respect to the transaction at issue. In combination, however, I find the plaintiff has alleged particular facts that support a reasonable doubt as to Pollock's independence with respect to Globe's Financial Services Transactions. Since Clegg, Klikus, and Pollock made up a majority of the Globe board of directors at the time the complaint was filed, demand is excused with respect to claims arising from the Financial Services Transactions.

B. The Clegg-Globe Marketing Services Transactions

In 1994, Globe allegedly paid $ 150,000 Catalog Holdings, Inc. ("CHI"), a corporation **[*16]** alleged to be controlled by Mr. Clegg, purportedly in consideration for the future placing of advertisements for Globe's products in the catalog of H.I., Inc., a wholly-owned subsidiary of CHI. In addition, Globe allegedly received an option expiring August 1, 1997 to purchase 3,275 shares of CHI common stock for $ 100 per share. Fund asserts that H.I., Inc. was a new company with a limited customer base and limited retail catalog distribution. Additionally, Fund claims that shingles for residential roofing, Globe's principle product, are not generally advertised directly to consumers. Finally, Fund asserts that

CHI's current market value is far below $ 100 per share, implying that the value of the options Globe received is relatively low.

The same analysis that led me to conclude that the plaintiff had cast doubt on the Globe board's independence in approving the Financial Services Transactions for the purposes of excusing demand under Rule 23.1 applies to the Marketing Transactions. Consequently, demand is excused.

V. THE CLEGG-DIAMOND MARKETING SERVICES TRANSACTION

Simultaneously with the Globe-CHI transaction, Diamond allegedly paid $ 150,000 to CHI, purportedly for access **[*17]** to 3,000-4,000 sales leads and certain call center services from H.I., Inc., as well as options to purchase 3,275 shares of CHI common stock for $ 100 per share. However, plaintiff alleges that H.I., Inc. *had no such sales leads to sell and* that Diamond already owned a call service center. Thus plaintiff alleges that the transaction was self-interested, wasteful, and disloyal.

I find that plaintiffs have met their burden of casting doubt on the independence of the Diamond board with respect to this transaction, and that consequently, demand is excused. Plaintiff alleges, that as an owner of CHI, Mr. Clegg had a direct personal interest in Diamond's issuing securities to CHI in exchange for unnecessary marketing services. This allegation is sufficient to support a reasonable doubt as to Mr. Clegg's independence with respect to these transactions.

Mr. Gillespie is a director of Diamond and an employee of the company. Mr. Clegg, by virtue of his majority control of Globe and Globe's 80% ownership of Diamond, controls Diamond. Mr. Clegg, it is alleged, used this control in February, 1996, to remove an employee director for challenging his judgment on an allegedly self-interested **[*18]** transaction with respect to Mr. Clegg. As was the case with Mr. Klikus, plaintiff pleaded sufficient particular facts to support a reasonable doubt as to Gillespie's independence based on his being beholden to Mr. Clegg.

Finally, as to Mr. Pollock's independence, the same factual circumstances discussed above in relation to Mr. Pollock's involvement in the Clegg-Globe transactions apply to the Clegg-Diamond Marketing Services Transaction. The alleged firing and removal of Mr. Griffin speaks generally to how Mr. Pollock might view Mr. Clegg's approach to board management. Consequently, I conclude plaintiff has pleaded sufficient factually specific allegations to support a reasonable doubt that a majority of the Diamond Board at the time the complaint was filed were capable of independent judgement with resect to both the Clegg-Diamond Marketing Services Transactions and Mr. Clegg's alleged purchase of Handy Craftsman.

VI. THE PURCHASE OF THE CHESTER FACILITY

This claim relates to Globe's purchase of a shingle manufacturing plant from a company allegedly controlled by Mr. Pollock. Fund alleges this purchase was the product of Mr. Pollock's fraudulent self-dealing with the assistance **[*19]** of Mr. Clegg. Fund further alleges that Mr. Pollock and Mr. Clegg failed to disclose material information about the state of the shingle plant to the board in violation of their fiduciary duties. For the reasons that follow I conclude that these allegations do support a reasonable doubt as to the independence of the Globe board with respect to both the Chester Facility acquisition itself and the disclosure issue arising out of the acquisition. Thus plaintiff is excused from making presuit demand regarding these claims.

Fund alleges that during 1992 and January 1993, Globe leased a shingle manufacturing plant in Chester, West Virginia, from J. Pollock & Co. for $ 205,000 and that in February 1993, Mr. Clegg proposed to the Board of Globe that Globe purchase the Chester facility for $ 940,000. The Board approved the purchase. Fund alleges that at the time of the purchase Globe's shingle operations' sales and gross profits were declining, and its shingle plants were operating at less than full capacity. Fund also alleged that Mr. Clegg and Mr. Pollock knew at the time of the proposal to the board that the Chester facility was "deficient in design and structure," and failed to share their **[*20]** knowledge with Globe's other board members.

In early 1995, Mr. Clegg told the Board of Globe that Diamond was refusing to buy shingles from the Chester Facility. Mr. Lefkowitz later informed the Globe Board that he had learned the Chester Facility manufactured poor quality shingles due to the defects present at the time of Globe's purchase of the Chester Facility from J. Pollock & Co. In the fall of 1995, the Chester Facility was closed due to the product quality problems.

Since Mr. Pollock was a board member of Globe, Globe's purchase of the Chester Facility was an interested transaction insofar as he was concerned. However, plaintiffs have not alleged facts that directly would establish a conflict of interest with respect to other members of the Globe board with respect to the Chester Facility Acquisition. In fact, Mr. Clegg's 47% direct ownership of Globe gives him a substantial direct financial interest in Globe obtaining fair terms in the transaction. The complaint alleges Mr. Clegg and Mr. Pollock acted together to mislead the other members of the board into entering purchasing the facility. The complaint does not

allege Mr. Clegg's motive for acting against his economic interest, [*21] but the clear implication of the complaint as a whole is that Mr. Clegg relied on Mr. Pollock's support in effectuating numerous other transactions that benefited Mr. Clegg carrying out his own allegedly disloyal actions. It is one possible and not unreasonable inference that all the alleged actions complained of together constituted a common scheme by Mr. Clegg and Mr. Pollock. While a finding that such a plan or scheme actually existed would require proof, as a matter of pleading I am satisfied that plaintiff has raised a reasonable doubt as to Mr. Clegg's independence, and thus the independence of a majority of the Globe board, with respect to Globe's acquisition of the Chester Facility.

In addition, plaintiff has alleged that both Mr. Clegg and Mr. Pollock knew at the time of the Globe board's consideration of the Chester Facility Acquisition that the Facility had design and structural flaws rendering it incapable of producing salable shingles. Plaintiff further alleges Clegg and Pollock concealed this information from the board. Such concealment would violate both directors' duty to disclose to other directors. *Hoover Industries v. Chase, Del. Ch., C.A. No. 9276, 1988 Del. Ch. LEXIS 98*, *7 [*22] (July 13, 1988). With respect to this alleged breach of fiduciary duty, Mr. Pollock has an alleged direct financial interest casting doubt on the applicability of the business judgement rule. Mr. Clegg stands accused of a breach of duty of a more serious nature than the mere approval of the challenged transaction, and Mr. Klikus is, for the purpose of this transaction as well as the Clegg-Globe transactions, subject to reasonable doubts to his independence due to his being beholden to Clegg for his position as an employee of Globe. Consequently, as to allegations of breach of fiduciary duty due to Mr. Clegg and Mr. Pollock's alleged failure to disclose to the Globe board, plaintiff is excused from the demand requirement of Rule 23.1.

VII. THE HANDY CRAFTSMAN TRANSACTIONS AND THE DIAMOND IPO

On May 12, 1994, the Diamond board allegedly specifically agreed to prohibit any officer from investing in a competitor of Diamond. The complaint is silent as to what form this agreement took. The exact nature of this agreement is of minor relevance in light of the existence of the corporate opportunity doctrine. In 1995, Mr. Clegg acquired Handy Craftsman, allegedly a competitor of Diamond's [*23] in the home improvement and repair business. This acquisition is the subject of plaintiff's claim for usurpation of a corporate opportunity.

In early 1996, Clegg approached the Donald Griffin, then the Chief Executive Officer of Diamond, and asked Mr. Griffin to arrange for Diamond to buy Handy Craftsman from him. Mr. Griffin allegedly refused to do so at the price Mr. Clegg wanted. Shortly thereafter, Mr. Clegg allegedly removed Mr. Griffin from the Diamond board, and had him dismissed from his position as Chief Executive Officer.

On April 19, 1996, Diamond filed a Form S-1 with the United States Securities and Exchange Commission, registering a public offering of 3,420,000 shares of Diamond, including a secondary offering of 833,000 Diamond shares owned by Globe. Mr. Clegg allegedly did not seek or obtain the consent of the Globe board for the sale of Globe's 833,000 Diamond shares. These shares constitute one-third of Globe's holding in Diamond. Mr. Lefkowitz has allegedly objected to Globe's sale of Diamond stock.

In its S-1 dated April 19, 1996, Diamond states it is going to acquire all or substantially all of the assets of Handy for $ 2,000,000. As of this date, the purchase [*24] of Handy Craftmen's assets has not been completed.

On the basis of these allegations, plaintiff brings claims derivatively against Mr. Clegg for usurping a corporate opportunity in violation of a board decision when he purchased Handy Craftsman; acting without authority to sell Globe's Diamond holdings in the 1996 IPO, and violating his duty of loyalty by arranging for Diamond's purchase of Handy Craftsman's assets for a price plaintiff alleges is "grossly in excess of their true worth."

A. Ripeness

Defendant's motion to dismiss seeks to have claims related to Diamond's pending acquisition of Handy Craftsman dismissed as unripe. Defendant argues that no contract for sale of Handy Craftsman exists, and that consequently there is no transaction for this court to review. Plaintiff's response is that an agreement in principle has been reached, which imposes certain obligations on both parties to complete the negotiations, and that consequently the terms on which agreement have been reached thus far are reviewable by this court.

This aspect of the defendant's motion applies solely to the plaintiff's claims of breach of the fiduciary duty of loyalty asserted in relation to the sale of [*25] Handy Craftsman to Diamond. It is not a defense to plaintiff's claim of usurpation of corporate opportunity directed at Mr. Clegg's 1995 completed acquisition of Handy Craftsman.

As to the proposed Diamond acquisition, the law of contracts has long reflected the interdependent nature of the specific terms of a contract under negotiation. Consequently, mere agreements to agree are unenforceable at common law. However, plaintiff asserts that agreements

to negotiate in good faith may be enforced if all the material terms of the contract have been agreed to by the parties. [3] Plaintiff has alleged Diamond "is paying" $ 2,000,000 for Handy. Plaintiff does not allege that Diamond has executed a contract purchasing Handy or its assets, or that all material terms of such a contract have been agreed to by the relevant parties. Plaintiff only alleges Diamond has announced its intention to make such an acquisition at a particular price. Price is not the only material term in such a contract, and consequently no contractual obligation has been created. Diamond has taken no action this court can review in connection with its announced intention to acquire Handy. Consequently, all claims for breach **[*26]** of fiduciary duty in relation to Diamond's announced intention to acquire Handy are dismissed without prejudice.

3 Neither party seeks to show what the governing state law is for the alleged agreement in principle between Diamond and Handy. Fortunately, Delaware law, Indiana law (Diamond's principle place of business), Illinois law (Clegg's place of residence), and New York law (a common jurisdiction specified in merger and acquisition contracts) all require the parties to have reached agreement on all material terms before an "agreement to agree" will be enforced. *VS&A Communications Partners, L.P. v. Palmer Broadcasting L.P., Del. Ch., C.A. No. 12521, 1992 Del. Ch. LEXIS 136*, *10, Allen, C. (July 14, 1992); *Kinko's Graphics Corp. v. Townsend, Ind. D., 803 F. Supp. 1450 (1992)*; *Wagner Excello Foods, Inc. v. Fearn Int'l, Inc., Ill. App., 235 Ill. App. 3d 224, 601 N.E.2d 956, 176 Ill. Dec. 258 (1992)*; *Teachers Ins. & Annuity Ass'n of America v. Butler, S.D.N.Y., 626 F. Supp. 1229 (1986)*.

B. Demand Futility **[*27]** with Respect to the Claim Arising from Clegg's Acquisition of Handy Craftsman

The reasoning that has led me to excuse the demand requirement in relation to plaintiff's other claims on behalf of Diamond against Mr. Clegg applies with particular force to plaintiff's claim of usurpation of corporate opportunity. Here plaintiff alleges that Mr. Clegg has removed a director specifically over issues relating to Mr. Clegg's investment in Handy Craftsman. This easily casts a reasonable doubt on the ability of Mr. Klikus, a Diamond employee, and Mr. Pollock, who was engaged in a web of dealings with Mr. Clegg, to act independently in reviewing plaintiff's allegations regarding Mr. Clegg's alleged purchase of a competing business.

C. Demand Futility With Respect to the Claim Arising from Prospective Sale of Globe's Stock in Diamond

Plaintiff alleges that Clegg arranged for Globe to include a portion of its investment in Diamond in a forthcoming sale of Diamond stock to the public without Globe's board approving the transaction. However, plaintiffs do not specify how these alleged facts constitute a wrong. Plaintiffs generally allege self-dealing by Mr. Clegg and Mr. Pollock, but this sale **[*28]** to the public is not a self-dealing transaction. A reasonable inference would be that the claim here is that Mr. Clegg as an officer exceeded his authority by selling a substantial portion of Globe's assets without board approval. As a general matter, corporate officers have the "inherent" authority to engage in acts "arising in the usual and regular course of business" without obtaining board approval. *Lee v. Jenkins Brothers, 268 F.2d 357 (2d Cir. 1959)*, cert. denied *361 U.S. 913, 80 S. Ct. 257, 4 L. Ed. 2d 183*, as cited in William L. Cary and Melvin Aron Eisenberg, CORPORATIONS: CASES AND MATERIALS, 300 (7th Ed. 1995). As is often the case in corporation law, there is no bright line distinguishing the ordinary business decision from the extraordinary one. Plaintiffs here allege that all of Globe's 1995 pre-tax earnings came from its stake in Diamond. Consequently, I find these allegations support a reasonable inference that the decision to sell a third of that stake in a public offering was an extraordinary one requiring board approval.

However, plaintiffs have not alleged any facts suggesting this transaction was an interested one or that the board was in any way unable to **[*29]** review this particular action independently. Consequently, plaintiff's claim relating to the sale of Diamond stock is dismissed pursuant to Rule 23.1.

VIII. CONCLUSION

For the reasons set forth, the plaintiff's claims arising out of Diamond's efforts to purchase Handy Craftsman and Globe's efforts to sell a portion of its interest in Diamond are dismissed without prejudice. As to the remainder of the plaintiff's claims, the individual defendants' motion to dismiss is DENIED.

TAB 6

LEXSEE 2006 DEL CH LEXIS 179

POLYGON GLOBAL OPPORTUNITIES MASTER FUND, Plaintiff, v. WEST CORPORATION, Defendant.

C.A. No. 2313-N

COURT OF CHANCERY OF DELAWARE, NEW CASTLE

2006 Del. Ch. LEXIS 179

September 21, 2006, Submitted
October 12, 2006, Decided

NOTICE:

[*1] THIS OPINION HAS NOT BEEN RELEASED FOR PUBLICATION. UNTIL RELEASED, IT IS SUBJECT TO REVISION OR WITHDRAWAL.

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OPINION

MEMORANDUM OPINION AND ORDER

LAMB, Vice Chancellor.

I.

A hedge fund that invests in event arbitrage situations purchased a significant amount of the stock of a corporation following the announcement of the corporation's going private recapitalization transaction. The hedge fund seeks to inspect the company's books and records pursuant to *8 Del. C. § 220* for the purposes of valuing its stock to determine whether to seek appraisal, to investigate alleged breaches of fiduciary duty that [*2] occurred before its purchase of stock, and to communicate with other stockholders. As the court finds the hedge fund already has all necessary, essential, and sufficient information to determine whether or not to seek appraisal, does not have a proper purpose to investigate wrongdoing that allegedly occurred before it bought its shares (and, in fact, led to its decision to invest), and does not seek a stockholder list to communicate with other stockholders, the complaint will be dismissed.

II.

A. The Parties

The plaintiff, Polygon Global Opportunities Master Fund, is a global multi-strategy arbitrage fund with approximately $ 4.5 billion under management. Polygon is organized as a Cayman Islands exempted company. Polygon engages in and seeks to maximize fund value through merger and event arbitrage. The defendant, West Corporation ("West Corp." or "the company"), is a Delaware corporation with its principal place of business in Omaha, Nebraska. West Corp. provides outsourced communication solutions. Gary and Mary West are the controlling stockholders of West Corp., but are not parties to this action.

B. The Facts

1. West Corp.'s Proposed Recapitalization

[*3] On May 31, 2006, West Corp. announced what is described as a leveraged recapitalization. The recapitalization--that will take the form of a squeeze-out merger--is sponsored by an investor group led by Thomas H. Lee Partners and Quadrangle Group, LLC. The controlling stockholders, Gary and Mary West, are participating in the recapitalization and exchanging part of their stock for equity in the resulting entity. The other stockholders will receive cash for all of their stock. A

special committee of independent directors, with Morgan Stanley & Co. as its financial advisors and Potter Anderson & Corroon as its legal advisors, was created to negotiate the transaction with the buyout group. Gary and Mary West reportedly did not participate in the negotiations. Ultimately, the special committee recommended and approved the recapitalization.

Under the terms of the recapitalization, West Corp.'s minority stockholders will be entitled to receive $ 48.75 per share in cash. This amount represents a 13% premium over the company's closing stock price the day before the transaction, but is below the trading level of the stock a month prior. Gary and Mary West will sell approximately 85% of their [*4] stock in the company for $ 42.83 in cash and will convert the remaining 15% into shares of the surviving corporation. According to the proxy materials, this 15% equity investment is based on the same $ 42.83 per share valuation. The company's press release states that the different treatment for the Wests was requested by the special committee and required by the investor group in order to deliver a higher cash price to the public stockholders.

The Wests have agreed to vote their shares in favor of the transaction, guaranteeing the approval of the recapitalization. [1] Polygon realizes this fact, and admits there is functionally nothing it can do to stop the deal. The merger agreement provides for a 21-day "go shop" period during which West Corp. actively shopped the company and solicited other acquisition proposals. After this go shop period, the merger agreement still permits the company to respond to unsolicited proposals or further proposals from persons solicited during the go shop period. The agreement also contains a fiduciary out that permits the special committee to change its recommendation and thereby terminate the Wests' voting agreement.

1 The Wests' voting agreement would terminate if the special committee changes its recommendation on the transaction.

[*5] 2. The History Of Polygon's Ownership Of West Corp. Stock

Polygon made its first purchase of West Corp. stock immediately after the announcement of the proposed recapitalization because it believed that the situation presented an attractive risk arbitrage opportunity. As of September 14, 2006, Polygon owned 3,268,300 shares of West Corp. common stock purchased at a total cost of $ 157,924,117.37.

3. The Demand Letters

On June 28, 2006, Polygon made a written demand on West Corp. seeking production of certain books and records. On July 6, 2006, West Corp.'s attorneys rejected Polygon's demand on the basis that it was not made under oath and, therefore, did not comply with the technical requirements of *section 220*, and also because it failed to state a proper purpose. On July 11, 2006, Polygon made another demand, this time under oath, again seeking production of certain books and records. West Corp. responded on July 18, 2006 and refused the demand. Polygon offered to narrow its request on July 26, 2006, an offer that West Corp. refused two days later. This lawsuit was filed on July 31, 2006. Following the initiation of this lawsuit, the court asked Polygon to produce a [*6] chart linking the categories of documents it continued to seek with a proper purpose asserted in the demand. In connection with the submission of the chart, Polygon pared down its request, eliminating several categories of demands.

III.

Polygon claims three purposes it contends are proper under *section 220*. First, it states it has a proper purpose in valuing its shares to determine whether to seek appraisal. [2] Second, it argues it has a proper purpose in investigating mismanagement and potential breaches of fiduciary duties by the Wests and West Corp.'s directors, pointing out that the Wests are being treated differently than the other stockholders. In this connection, Polygon argues that the 21-day go shop period was too short and may have acted as an obstacle to other potential bidders, and that the financial terms of the recapitalization fail to offer what Polygon considers a "meaningful premium." [3] Polygon also argues that West Corp. management gave conservative earnings guidance prior to the announcement of the transaction. Third, Polygon maintains it has a proper purpose in communicating with other stockholders to provide them with information they may consider of interest [*7] and to encourage them to seek appraisal. Polygon also notes that the transaction is subject to an "appraisal out" pursuant to which the investor group can abandon the deal if a sufficient number of stockholders seek appraisal. [4] It presumably mentions this fact to counter the assertion that it cannot prevent the transaction from going forward as planned.

2 Pl.'s Pretrial Br. at 6-8.
3 *Id.* at 9.
4 *Id.* at 12-13. The appraisal out can be waived.

West Corp. responds that none of Polygon's purposes are proper because it is an "interloper," a greenmailer, and seeks to benefit itself at the expense of other stockholders. [5] West Corp. further contends that Polygon does not need any additional information to value its stock

and, therefore, valuation for determining whether to seek appraisal is not a proper purpose under the circumstances because all necessary and essential information is publicly available. [6] With regard to communicating with other stockholders, the company argues that [*8] doing so is adverse to the interests of the corporation and does not meet the compelling circumstance standard for a *section 220* demand to communicate with other stockholders in this context. [7] Finally, West Corp. maintains that Polygon does not have a proper purpose to investigate wrongdoing because the alleged wrongdoing occurred before its purchase of the stock, and, in any event, Polygon cannot demonstrate any credible basis of wrongdoing. [8]

5 Def.'s Pretrial Br. at 15-16

6 *Id.* at 18.

7 *Id.* at 31, 34 (citing *Highland Select Equity Fund, L.P. v. Motient Corp., 906 A.2d 156, 2006 Del. Ch. LEXIS 127, 2006 WL 2589410, at *9 (Del. Ch. July 6, 2006)* (requiring "the kind of compelling circumstance this court described in *Disney,* that would authorize the use of *Section 220* as a way of publicizing concerns about mismanagement").

8 *Id.* at 25-31.

IV.

Delaware law provides a statutory right for a stockholder to inspect the books and records of a corporation under *8 Del. C. § 220* [*9] . This statutory right is conditioned on form and manner requirements and on the stockholder's purpose for inspection being a proper one. [9] The parties have stipulated that Polygon has complied with the requirements of *section 220* with respect to the form and manner of making its demand. [10] The statute defines "proper purpose" as any purpose "reasonably related to such person's interest as a stockholder." [11] If a books and records demand is to investigate wrongdoing that occurred prior to the purchase of stock, the plaintiff must have a proper purpose "reasonably related to his interest as a stockholder" and must further prove that he has some credible evidence of wrongdoing sufficient to warrant continued investigation. [12] It is not enough for a *section 220* claim, however, merely to satisfy the proper purpose and credible evidence prongs of the test. Even if the technical requirements of *section 220* are met and the plaintiff's purpose is proper, "[t]he scope of inspection should be circumscribed with precision and limited to those documents that are necessary, essential and sufficient to the stockholder's purpose." [13] The court will limit or deny any inspection to the extent [*10] that the requested information is available in the corporation's public filings. [14]

9 *Highland, 2006 Del. Ch. LEXIS 127, 2006 WL 2589410, at *6.*

10 Joint Pretrial Stipulation and Order III P 2.

11 *8 Del. C. § 220(b).*

12 *See Seinfeld v. Verizon Commc'ns, Inc., 909 A.2d 117, 2006 Del. LEXIS 492, 2006 WL 2771558, at *5 (Del. Sept. 25, 2006)* ("We remain convinced that the rights of stockholders and the interests of the corporation in a *section 220* proceeding are properly balanced by requiring a stockholder to show 'some evidence of *possible* mismanagement as would warrant further investigation.'") (emphasis in original) (citing *Security First Corp. v. U.S. Die Casting & Dev. Co., 687 A.2d 563, 568 (Del. 1997))*; *Saito v. McKesson HBOC, Inc., 806 A.2d 113, 117 (Del. 2002)* ("If activities that occurred before the purchase date are 'reasonably related' to the stockholder's interest as a stockholder, then the stockholder should be given access to records necessary to an understanding of those activities.") (citations omitted). [*11]

13 *Marathon Partners, L.P. v. M&F Worldwide Corp., 2004 Del. Ch. LEXIS 101, 2004 WL 1728604, at *4 (Del. Ch. 2004).*

14 *See* DONALD J. WOLFE, JR. & MICHAEL A. PITTENGER, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 8.6(e)(1) (2005) ("Thus, to the extent that information sufficient to permit the valuation is contained in publicly available records, the inspection of corporate books and records for the purpose of such a valuation exercise will be denied."); *see also DPF, Inc. v. Interstate Brands Corp., 1975 Del. Ch. LEXIS 210, 1975 WL 1963, at *2 (Del. Ch. Oct. 2, 1975)* ("the stock is not only traded on the New York Stock Exchange but it is also registered with the Securities and Exchange Commission pursuant to *Section 12 of the Securities Act of 1934*.... [T]he plaintiff could well already have access to all the information that it is reasonably and fairly entitled to receive for the purpose stated [valuation of stock].").

A. Polygon Has A Proper Purpose In Valuing Its Stock For Appraisal, But Has All "Necessary And Essential" Information From Public Filings

[*12] The threshold matter the court must address is whether Polygon has a proper purpose for inspecting the books and records of West Corp. It is settled law in Delaware that valuation of one's shares is a proper purpose for the inspection of corporate books and records. [15] Through its submissions and at trial, West Corp. maintains that Polygon does not have a proper purpose for

valuing its stock, but, instead, is abusing *section 220* for its own benefit to the detriment of the company and other stockholders. The evidence at trial did not support this assertion.

15 *CM & M Group, Inc. v. Carroll, 453 A.2d 788, 792 (Del. 1982).*

Polygon's overriding purpose is to "maximize value" for its fund. There is nothing necessarily improper about this motive, in pursuit of which Polygon explores all options, including the possibility of seeking appraisal and communicating with other West Corp. stockholders about the information it obtains and viewpoints it develops about that information. The evidence at **[*13]** trial did show that Polygon, in previous transactions, has voted down agreements to advance its personal interests. Yet here, as Polygon admits, it can do nothing to stop this transaction. Furthermore, there is no evidence that Polygon is doing anything improper with regard to the transaction. Polygon simply saw an opportunity to purchase stock in West Corp. at what it feels was an attractive price. West Corp. has not demonstrated an improper motive, and Polygon's motive to value its stock in order to make a decision on whether to seek an appraisal is proper.

Polygon seeks additional information beyond that in West Corp.'s public filings in order to value its stock to determine whether or not to seek appraisal, yet it has not shown that the information made publicly available in connection with the proposed recapitalization transaction omits information that is necessary, essential, and sufficient for its purpose. There is a dichotomy in *section 220* cases between publicly traded companies and closely held companies. With regard to the former, public SEC filings typically provide significant amounts of information about a company, and decisions granting *section 220* demands are narrowly **[*14]** tailored to address specific needs, often in response to allegations of wrongdoing. [16] In contrast, stockholders in non-publicly traded companies do not have the wealth of information provided in SEC filings and are often accorded broader relief in *section 220* actions. [17]

16 *See, e.g., Carapico v. Phila. Stock Exch., 791 A.2d 787 n.13 (Del. Ch. 2000)* ("Of course, a person making a *§ 220* demand is entitled to demand documents by category and will frequently not be in a position to demand specific documents. What is required is that, at least where the purpose is to investigate particularized claims of mismanagement, the categories of documents be identified more narrowly and precisely than is typical in ordinary civil discovery.").

17 *See, e.g., Macklowe v. Planet Hollywood, Inc., 1994 Del. Ch. LEXIS 182, 1994 WL 560804, at *4 (Del. Ch. Sept. 29, 1994)* ("When a minority shareholder in a closely held corporation whose stock is not publicly traded needs to value his or her shares in order to decide whether to sell them, normally the only way to accomplish that is by examining the appropriate corporate books and records.") (citing *Helmsman Mgmt. Servs., Inc. v. A & S Consultants, Inc., 525 A.2d 160, 164 (Del. Ch. 1987)).*

[*15] In the case of a going private transaction governed by SEC *Rule 13e-3*, [18] the amount of information made publicly available is even more comprehensive than that required in standard SEC periodic filings. Through its preliminary and final proxy materials, and its Schedule 13E-3, and amendments, West Corp. would appear to have disclosed all material information necessary for Polygon to determine whether or not to seek appraisal. This is not to say that there is a *per se* rule that the disclosure requirements under *Rule 13e-3* are coextensive with the "necessary, essential and sufficient" information standard under *section 220* demands for valuing stock in the case of a minority squeeze-out merger. Nevertheless, in the present case, the detail and scope of West Corp.'s disclosures makes this so. The disclosures include, among other things, all presentations made by Goldman Sachs and Morgan Stanley, detailed descriptions of their two fairness opinions, company projections, detailed descriptions of the board and special committee meetings, and terms of the Wests' investment in the surviving entity. This wealth of detailed information would appear to satisfy the obligation to disclose **[*16]** all facts material to the decision whether to demand appraisal.

18 *17 C.F.R. § 240.13e-3 (2006).*

Apparently anticipating the inherent problems with requesting additional information in the face of a transaction with comprehensive public disclosures, Polygon argues that it should be given access to the same information it would receive through discovery in an appraisal action. This argument misapprehends the significant difference in scope between a *section 220* action and discovery under Rule 34. The two are, in fact, "entirely different procedures." [19] *Section 220* is not intended to supplant or circumvent discovery proceedings, nor should it be used to obtain that discovery in advance of the appraisal action itself. [20] If Polygon wishes to receive the documents it seeks in this action, it must elect to seek appraisal and request them through the discovery process. To now permit Polygon additional information beyond the comprehensive disclosure already in the public domain simply **[*17]** because it could receive such

information in a later appraisal action through discovery would be putting the cart before the horse.

19 *Highland, 2006 Del. Ch. LEXIS 127, 2006 WL 2589410, at *7.*

20 *See Freund v. Lucent Techs., 2003 Del. Ch. LEXIS 3, 2003 WL 139766, at *4 (Del. Ch. Jan. 9, 2003)* (*Section 220* does not authorize a "broad fishing expedition").

B. Polygon's Purpose To Pursue A Derivative Claim For Breach Of Fiduciary Duty Is Not Reasonably Related To Its Interest As A Stockholder, Therefore, Its Second Purpose Is Not Proper

Polygon's sole purpose for investigating claims of wrongdoing is to determine whether the board members "breached their fiduciary duties in approving the Recapitalization Transaction." [21] This purpose is not reasonably related to Polygon's interest as a stockholder as it would not have standing to pursue a derivative action based on any potential breaches. [22] Likewise, Polygon could not pursue a direct claim or class action based on entire fairness. [23] Delaware has **[*18]** a "public policy against the 'evil' of purchasing stock in order to 'attack a transaction which occurred prior to the purchase of the stock.'" [24] This is precisely what Polygon is attempting to do. In fact, it purchased West Corp. stock after the announcement of the transaction proposal because it felt the consideration offered was too low.

21 Compl. P 5.

22 *See Saito, 806 A.2d at 117* ("If a stockholder wanted to investigate alleged wrongdoing that substantially predated his or her stock ownership, there could be a question as to whether the stockholder's purpose was reasonably related to his or her interest as a stockholder, especially if the stockholder's only purpose was to institute derivative litigation. But stockholders may use information about corporate mismanagement in other ways, as well. They may seek an audience with the board to discuss proposed reforms or, failing in that, they may prepare a stockholder resolution for the next annual meeting, or mount a proxy fight to elect new directors."). Obviously, in this case, where Polygon will cease to be a West Corp. stockholder once the transaction is effected, none of these other possibilities can be thought to exist.

[*19]

23 *Omnicare, Inc. v. NCS Healthcare, Inc., 809 A.2d 1163, 1170 (Del. Ch. 2002)* ("The policy animating *8 Del. C. § 327* is not, however, limited to derivative claims alone. Rather, that policy is derived from 'general equitable principles' and has been applied to preclude stockholders who later acquire their shares from prosecuting direct claims as well.") (citation omitted).

24 *Id. at 1169 (Del. Ch. 2002)* (quoting *Rosenthal v. Burry Biscuit Corp., 30 Del. Ch. 299, 60 A.2d 106, 111 (Del. Ch. 1948))*; *8 Del. C. § 327* (barring a stockholder from bringing a derivative suit unless the stockholder owned stock at the time of the alleged wrong).

To permit Polygon additional information to attack a transaction when it purchased stock knowing of the proposed transaction, indeed because of it, would be contrary to Delaware public policy. Nothing in *Saito v. McKesson HBOC, Inc.* is to the contrary. As discussed in that opinion, Saito first bought shares of McKesson common stock months before news of **[*20]** any financial irregularity at McKesson's merger partner, HBOC, was made public. [25] Thus, Saito's *section 220* request did not contravene Delaware's strong public policy against purchasing grievances. As Polygon's purpose is not reasonably related to the alleged past breaches of fiduciary duty by the board of West Corp. in approving the recapitalization transaction, it does not have a proper purpose to investigate possible wrongdoing.

25 *806 A.2d at 115.*

Moreover, even if Polygon were an appropriate person to investigate the circumstances of this going private transaction, at trial Polygon did not carry its burden of showing a credible basis from which the court could infer fiduciary misconduct warranting further investigation. Quite simply, there is nothing about the history of the negotiation or the structure or pricing of the proposed transaction that amounts to a "credible showing" of "legitimate issues of wrongdoing." [26]

26 *Security First Corp., 687 A.2d at 568.*

[*21] C. Polygon's Purpose To Communicate With Other Stockholders Is Moot

Polygon's third stated purpose is to communicate with other stockholders. A *section 220* complaint seeking a stockholder list for communication with other stockholders is rarely denied because the burden is placed on the corporation to prove the plaintiff has an improper purpose. [27] Here, Polygon does not seek a stockholder list and does not intend to conduct any regulated solicitation of proxies. Instead, in its demand letter, Polygon states that it wants to communicate the information it receives through this *section 220* demand to other stockholders. In connection with the trial, Polygon stated that it wishes to communicate with other stockholders about the fairness of the transaction and their decision to seek appraisal

(although presumably only with a small number of other stockholders in an unregulated fashion). [28] In either case, these statements of purpose are derivative of, and dependent upon, Polygon's first two purposes. Because, as has already been discussed, neither of those purposes supports any inspection under *section 220*, Polygon's third purpose also fails. Quite simply, while Polygon is **[*22]** free to communicate with other stockholders in compliance with the federal securities laws, that purpose does not, itself, support any inspection of West Corp.'s books and records.

27 *See 8 Del. C. § 220(c)* ("Where the stockholder seeks to inspect the corporation's stock ledger or list of stockholders and establishes that such stockholder is a stockholder and has complied with this section respecting the form and manner of making demand for inspection of such documents, the burden of proof shall be upon the corporation to establish that the inspection such stockholder seeks is for an improper purpose.").

28 Pl.'s Pretrial Br. at 12-13.

V.

For the foregoing reasons, the complaint is DISMISSED and judgment is entered in favor of West Corp. IT IS SO ORDERED.

TAB 7

LEXSEE 1983 DEL CH LEXIS 405

ROBERT M. SHAY, Plaintiff, vs. MORLAN INTERNATIONAL, INC., a corporation of the State of Delaware, Defendant.

Civil Action No. 7243

COURT OF CHANCERY OF DELAWARE, NEW CASTLE

1983 Del. Ch. LEXIS 405

Submitted July 27, 1983
July 29, 1983, Decided

PRIOR HISTORY: [*1] Upon Plaintiff's application for a Stockholders Meeting.Granted.

COUNSEL: William Prickett of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, for Plaintiff.

Martin P. Tully, Thomas Reed Hunt, Jr. and Peter W. Laberee of Morris, Nichols, Arsht & Tunnell, Wilmington, for Defendant.

OPINION BY: LONGOBARDI

OPINION

LONGOBARDI, V.C.

The Plaintiff seeks an order of this Court pursuant to *8 Del.C. § 211* compelling the Defendant corporation to schedule and hold an annual meeting for stockholders during the week of August 8, 1983.

The complaint indicates that the Plaintiff is a common stockholder and director of the Defendant corporation and that the Defendant held its last annual meeting on February 24, 1982. The answer admits these allegations but also alleges three affirmative defenses. In these affirmative defenses, the Defendant contends (1) that this action is moot because the Board of Directors has already scheduled an annual meeting for October 31, 1983; (2) that Plaintiff should be "barred from equitable relief" because he, as a director, acquiesced in any delay in setting the time for an annual meeting; and (3) that Plaintiff has unclean hands and should be denied "equitable [*2] relief."

Trial on this matter was concluded Thursday, July 21, 1983. The parties requested an opportunity for summation by letter memoranda and the Court agreed to an accelerated schedule by which the last memorandum was to be received by the Court on Wednesday, July 27, 1983.

It appears that Morlan International, Inc. ("Morlan") is a public corporation registered with the Securities and Exchange Commission and has approximately 650 shareholders spread throughout the United States. Morlan is the owner and operator of a number of cemeteries in various states and is required to maintain one or more trust funds for the perpetual care of those cemeteries. Those trust funds were valued as of September 30, 1980, at approximately 13.4 million dollars. Plaintiff, Robert M. Shay ("Shay"), is a stockholder, director and former chief executive officer of Morlan. He and his family own or have voting powers over 30% to 40% of the outstanding shares of Morlan. After his resignation as chief executive officer, the corporation retained special counsel to conduct an investgation of allegations of directorial improprieties that had been leveled against Shay and others. At the April 27, 1983, [*3] Board of Directors meeting, the Board, having received special counsel's report and the advice of independent counsel for litigation, authorized the filing of a complaint against Shay in the Federal District Court for the Eastern District of Pennsylvania ("the federal action"). The allegations of that complaint accuse Shay and an associate of serious misconduct but, it is important to note at this stage and for these proceedings that the federal action's allegations are merely accusations against Shay which have not been proven. The important fact for the purposes of this action is that there is a legal dispute between the corporation and Shay and a claim by Shay against the corporation.

At a Board of Directors meeting on March 25, 1983, Shay, together with all other Directors who were then present, voted unanimously against setting a date for an

annual meeting. Subsequently, Shay never formally requested the Board to schedule an annual meeting date. Shay did testify, however, he "raised the question with Mr. Demchick,... chairman of the executive committee, on a number of occasions and made it very clear that [he] thought the shareholders meeting should be held." (Transcript, [*4] p. 41 ["T-41"].) (The quotation leaves something to be desired if it were meant to convey that he demanded an annual meeting.) Finally, Shay filed this suit on July 11, 1983.On July 15, 1983, the Board of Directors convened by telephone and, among other things, scheduled an annual meeting of shareholders for October 31, 1983.

Defendant's first contention is that this action is moot and should, therefore, be dismissed. This contention is without merit. The thrust of the argument is that the Board of Directors has already scheduled a meeting and, therefore, the Plaintiff has gotten all that *8 Del.C. § 211* can provide. Defendant suggests that since the Board has fixed a date for the annual meeting, this Court has been ousted of its jurisdiction to fix the time, place and circumstances under which the meeting is to be held. Such a proposition is untenable and is specifically rejected.

The Defendant next contends that the meeting should not be scheduled for the week of August 8, 1983, because of Shay's unclean hands and his inequitable conduct. The unclean hands argument rests on the contention that Shay, at an earlier date, acquiesced in postponement of the annual meeting [*5] by the Board and should not now be allowed to demand a meeting. This argument is rejected. The Court cannot ascertain any prejudice to the corporation by Shay now demanding a meeting under *section 211*, particularly since control of the time frame and conditions for the meeting lie within the discretion of this Court. See *8 Del.C. § 211*; *Tweedy, Browne & Knapp v. Cambridge Fund, Inc., Del.Ch., 318 A.2d 635 (1974)*. Furthermore, the proposition that a director may not change his mind about the necessity of an annual meeting and is forever bound by his participation in a delay is without merit. There may be situations when this could occur but that is not this case.

The claim of inequitable conduct is directed at what Morlan supposes is Shay's plan of attack; that is, that Shay will gain control of the corporation if an immediate annual meeting is held quickly because few shareholders will be present by proxy or otherwise to outvote the combined votes he controls. Once in control of the corporation, they fear he will dismiss the federal action. During the trial, Shay would only say that, in this regard, he would be guided by the advice of counsel and his duties as a director. [*6] In other words, there is the possibility that this would happen and there is also the possibility it would not happen.

Lurking somewhere in between the unclean hands allegations and the "inequitable conduct" that is anticipated is the more fundamental concern by Morlan that if an annual meeting were scheduled within the next ten days, the shareholders would not be adequately apprised of all the facts necessary to vote in an informed way. Shay contends that the shareholders were informed of the existence of the federal action when the annual report was mailed to them in April, 1983. Morlan contends that the shareholder list has changed since April, 1983, that there has been an amended complaint filed and that other motions have been filed in the federal action, of which the shareholders have no knowledge.In addition, Morlan contends the information mailed with the annual report was exceedingly sparse. Morlan insists what to allow a stockholders meeting to be scheduled during the second week of August, 1983, would amount to an "ambush" tactic (a catch phrase that has gained some popularity of late because it triggers immediate thoughts of unfair conduct.) As will be demonstrated, [*7] the Court shares this concern.

Title 8, Section 211 of the Delaware Code provides as follows:

(c) A failure to hold the annual meeting at the designated time or to elect a sufficient number of directors to conduct the business of the corporation shall not affect otherwise valid corporate acts or work a forfeiture or dissolution of the corporation except as may be otherwise specifically provided in this chapter. If the held on the date designated therefor, the directors shall cause the meeting to he held as soon thereafter as convenient. If there be a failure to hold the annual meeting for a period of 30 days after the date designated therefor, or if no date has been designated, for a period of 13 months after the organization of the corporation or after its last annual meeting, the Court of Chancery may summarily order a meeting to be held upon the application of any stockholder or director. The shares of stock represented at such meeting, either in person or by proxy, and entitled to vote thereat, shall constitute a quorum for the purpose of such meeting, notwithstanding any provision of the certificate of incorporation or bylaws to the contrary. The Court of Chancery [*8] may issue such orders as may be appropriate, including, without limitation, orders designating the time and place of such meeting, the record date for determination of stockholders entitled to vote, and the form of notice of such meeting.

The idea that the shareholders should be fully informed before they are called upon to vote is not new to this Court. Compare *Schnell v. Chris-Craft Industries, Inc., Del.Supr., 285 A.2d 437 (1971)*; *American Pacific Corporation v. Super Foods Services, Inc.*, Del.Ch., C.A. No. 7020, Longobardi, V.C. (Dec. 6, 1982). [1]

1 In *American Pacific Corporation v. Super Foods Services, Inc.*, C.A. No. 7020, the Court stayed a stockholders' meeting because conflicting proxy statements had created such confusion that the stockholders could not have been adequately informed. Their vote under those circumstances would have been meaningless.

The statute allows the Court a measure of discretion in fixing the time, place and conditions for the annual meeting. *Savin Business Mach. Corp. v. Rapifax Corp., Del.Ch., 375 A.2d 469 (1977)*; *Tweedy, Browne & Knapp v. Cambridge Fund, Inc., 318 A.2d 635*. Because the Court is concerned with an **[*9]** informed electorate, the Court believes such a consideration is appropriate when exercising its discretion in fixing the date and conditions of a shareholders meeting under *section 211*.

The Court cannot and must not, however, become embroiled in a tug of war between these litigants. The merits of their disputes can best be resolved in the federal forum and by the shareholders at their annual meeting. Having said this, the solution becomes eminently clear. Of course, the details of the parties' disputes should not be made part of this litigation. They are, after all, only allegations. But certainly, the stockholders should have some knowledge of the scope of the dispute so that the casting of their votes does not become a hollow exercise of a treasured right. "The annual meeting of stockholders for the purpose of electing directors is one of the few avenues available to a corporate stockholder to enable him to have a say in the destiny of his corporation." *Algeran, Inc. v. Connolly,* Del.Ch., C.A. No. 6557 at 2, Hartnett, V.C. (Oct. 5, 1981). [2] It is not the merits of the dispute that become the operative factors in this proceeding but the fact that there is a dispute. **[*10]** *Cf. Bertoglio v. Texas Intern. Co., 488 F.Supp. 630 (D.Del. 1980).* [3]

2 In *Algeran, Inc. v. Connolly,* C.A. No. 6557, the plaintiff requested relief under *8 Del.C. § 211*. The defendant requested time in which to raise money to prepare financial statements and proxy material for the annual meeting. The defendant contended the plaintiff had conspired to prevent the accumulation of assets for these purposes and hence the reason for the delay in fixing the time for an annual meeting. The court granted the relief requested.

3 While the Court is aware that *Bertoglio v. Texas Intern. Co., 488 F.Supp. 630*, involved questions of federal securities law, the philosophy of an informed corporate electorate is just as appropriate in this case.

The Court is faced with the counteracting demands of the language of *8 Del.C. § 211* which provides for "summary relief" and the case law suggesting that the Court issue "appropriate" orders designed to protect the reasonable expectations of the parties and the corporate electorate. The Court declines to decide the issue in the vaccum of the language found in *8 Del.C. § 211* suggesting summary disposition. The totality **[*11]** of circumstances surrounding this particular application must be weighed and balanced. *Savin Business Mach. Corp. v. Rapifax Corp., 375 A.2d 469*. And in this case, the scale does not tip in favor of having an annual meeting scheduled within two weeks. The customary time for notice of such annual meeting has been at least thirty days. The by-laws allow from ten to fifty days.An experienced director suggests a minimum of forty-five days because of mailing and the problems caused by stock held in "street names." The Court, in this case, accepts the parameters of those limitations as a beginning point. As previously noted, to allow the meeting to be scheduled without allowing time for preparation of proxy materials would, in this case, not adequately consider the rights and interests of the shareholders. Witnesses testified to a variety of times needed for Securities and Exchange Commission clearance of proxy materials. It ranged from a low of ten days to forth-five days. Under these circumstances, scheduling the meeting no later than seventy days from the date of this opinion serves the purpose of *8 Del.C. § 211* and the needs of the shareholders to be adequately informed **[*12]** of the current affairs of the corporation. [4] It is a time limitation that takes into consideration that the Plaintiff, only three and one-half months prior to filing his complaint, had voted affirmatively not to schedule an annual meeting. In addition, there was no evidence during the course of the trial that indicated the corporation was in any dire straits that would be exacerbated by delaying the annual meeting seventy days. It also provides an opportunity for the Plaintiff, in light of the fact that no meeting will be held immediately, to prepare proxy materials on his own behalf.

4 It should be noted that the claim for the necessity of delay in order to have proxy materials cleared by the Securities and Exchange Commission may not be successful in all *section 211* cases.

Lest this amount of time be construed as extraordinary, the Court has made references to at least two rather current cases in which the Court acknowledged the necessity for scheduling an annual meeting promptly and then allowed between sixty and seventy-one days. *Cf. Algeran, Inc. v. Connolly,* C.A. No. 6557; [5] *J. P. Griffin Holding Corporation v. Mediatrics, Inc., 1973 Del. Ch.*

LEXIS 153, Del.Ch., C.A. No. 4056, **[*13]** Marvel, V.C. (Jan. 30, 1973). [6]

5 See footnote 2, page 7 for factual background on this unreported decision.

6 The defense in this *8 Del.C. § 211* case was that the defendant needed time to raise cash to pay auditors and attorneys to prepare financial statements and other proxy materials. The sale of an asset was imminent and the defendant wanted the court to wait for the consummation of that sale. The action was filed in November, 1972, and a decision granting the relief requested was rendered in January, 1973.

The Defendants will be required to forthwith prepare and promptly file with the Securities and Exchange Commission whatever proxy material that can be readily prepared. Jurisdiction by the Court is retained so that the time for the meeting may be modified if circumstances suggest that modification is warranted due to, among other things, clearance being obtained from the Securities and Exchange Commission before the expiration of forty-five days. Defendants should note that the possibility of modification is not an invitation to delay.

At the meeting, the quorum requirement in Article II, Section 8 of the corporation by-laws shall be applicable. The **[*14]** record date for determining shareholders entitled to notice and to vote at said meeting shall be at the close of business on September 15, 1983, and the notice for the meeting shall issue no later than September 16, 1983.

IT IS SO ORDERED.